THE BANKER AS A LENDER

F. E. STEELE

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primarily in
one's own thought & ideals Jung

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Extro – interest directed towards the external world (including world of people) & in finding the values of life in the external world.

BY

F. E. STEELE

DIRECTOR OF STUDIES FOR LOCAL CENTRES OF THE INSTITUTE OF BANKERS; FORMERLY AN ASSISTANT GENERAL MANAGER OF THE WESTMINSTER BANK; AUTHOR OF "PRESENT-DAY BANKING"; GILBART LECTURER (UNIVERSITY OF LONDON), 1921; SOMETIME LECTURER IN BANKING AND CURRENCY TO THE LONDON CHAMBER OF COMMERCE

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PREFACE

VARIOUS books have been published, from time to time, on banking advances and on banking securities. What is the justification for a further book on what would appear to be the same theme ?

To some extent the title of this book is the answer to this question. It is not, solely, a book on advances, nor is it entirely concerned with securities, although both subjects are necessarily dealt with in it. It is more " personal " than this. It is about a person, the banker, in one of his many capacities—his most important capacity. It endeavours to show the banker's views, his judgments, his estimates, and his methods in dealing, not only with inanimate things such as advances and securities, but with persons ; with bank customers, with bill brokers, and others.

It is " personal " in another sense, in the sense that it embodies the results of a long and fairly varied personal experience, and that it includes, here and there after the first chapter, references to incidents which are mentioned, not only because they are in direct illustration of the point under consideration, but in the hope that their inclusion will impart to the subject a living, human interest.

May I give an illustration ? We have all read books on the money market, and excellent books too. My own method, in this book, of dealing with the banker as a lender to the money market has been to describe in their personal as well as in their business aspects the daily visits of the bill brokers to the banks and the manner in which their transactions are carried out. Even such a trifling matter as their appearance has

not been ignored, inasmuch as, trivial as such a detail is, it serves to give "verisimilitude to a bald and unconvincing narrative."

Moreover, a wholesome and salutary banking moral is not less effectively enforced by reason of the fact that the incident in which it is embodied happens to be somewhat amusing. My experience in lecturing on banking and currency subjects in a large number of provincial centres has shown me that while a bald statement of a banking principle may fall quite flat and almost unheeded, such a statement meets with an immediate response, and, what is much more important, remains in the memory of the hearers, when it is illustrated from a personal experience; and when, in addition, such experience happens to involve an element of humour, this by no means prevents the principle from taking root: in point of fact, it helps it to do so.

The book consists of four lectures. These were originally given in 1921 at King's College, University of London, as the Gilbart Lectures on Banking. Since then, some of them—especially the second and third—of course, added to and brought up to date on each occasion, as the others have been—have been given in various parts of the country; at places so far apart as Newcastle-on-Tyne and Plymouth, Bangor and Ipswich, Blackpool and Southampton.

When the lectures were originally given, and often since, I have been asked to publish them, but I have refrained hitherto from doing so, mainly because I have had an idea that as with sermons, so with lectures, once a homily has been printed and published, one is not supposed to deliver it again. This, however, does not trouble me now, for I must already have delivered these lectures at as many places as are likely to express

a wish to hear them, although my hearers in those places have often been so polite as to ask where they could obtain a report of them.

I have deliberately retained the lecture form because of its directness. I prefer, throughout, to say "you" to the reader for the same reason as that indicated in the earlier part of this preface. I believe the direct appeal to be better, for my purpose, than such an appeal as would have resulted if I had gone through the lectures and converted the "you" into "the reader."

The questions may naturally be asked, What class of reader is the book intended to help? To what section or sections of banking men is it addressed?

To some extent these questions are answered at the beginning of the first chapter. It is not intended for the trained lending official of our banking head offices, nor for the highly experienced men who manage the most important branches. These know as much as I about the subject. It is intended, mainly, for that very large class of men and women in banks who have little opportunity, in the course of their daily work, of seeing more than the merest fringe of their bank's lending operations, but many of whom, I know from my own experience and otherwise, seize with avidity any opportunity of getting to know more about those operations. I also believe that the book may prove of service, in parts at any rate, to the manager of the average branch and to his immediate assistants. When these come, as they will at times, to a passage on a part of the subject with which they are already well acquainted, all they have to do is to skip that part and look out for the next heading.

My chief concern, however, has been and is for the rank and file of banking men; for the thousands of

these who find themselves, year in and year out, performing routine duties, and many of whom have arrived at the stage of imagining that such duties will be all that will ever fall to their lot. With these men I have the deepest sympathy; a sympathy born of having, for many years, shared their lot, though never their despondent views as to the future. My advice to every one of these may be very concisely stated. It is this—carry out those routine duties, monotonous though they be, to the very best of your ability; concentrate on them, master them; perform them as well as they can possibly be performed; but fit yourself, all the time, in the bank and out of it, for something better. By observation, by study, by qualifying for the certificate of the Institute of Bankers, by every possible legitimate method, equip yourself for those duties which demand technical knowledge, as well as judgment and resource, and, having done this, let it be known that you have done so. Tell your manager, tell your inspector, that you have qualified for a higher post. Do not "badger" them about it, or you may become a nuisance to them and defeat your purpose, but do not let them forget it, and it is my profound conviction that the higher post will come. It may not come so soon as you would wish, but come it will.

Reverting, I repeat that it is in the hope of giving the rank and file of banking men some insight into the most important side of their business, and a greater interest in and knowledge of that business generally, that I have put these lectures into a form in which they are likely to come under the notice of a wider public than they have hitherto reached. Other and more direct assistance I hope to be able to render to the younger generation of banking men a few months

hence in the form of a short treatise on the steps which they may take with a view to fitting themselves for a successful banking career. The book will be a considerable expansion of the short talk on "How to Become a Banker," which I gave some time since by wireless from "2 L.O."

To those who wish to go more fully into the subject-matter of this book I recommend the following works, to which I am myself indebted, as will be found from my acknowledgments in the context: *Bank Credit*, by C. A. Phillips, Ph.D. (The Macmillan Company, New York); *The Country Banker*, by George Rae (John Murray); *Bankers' Advances*, by F. R. Stead (Pitman); and *Bankers' Tests*, also by F. R. Stead (Pitman). In reading the first of these, due allowance will naturally have to be made for certain differences in American and English banking methods, but I know of no English banking book which goes so fully and satisfactorily into the analysis of balance sheets. In *Bankers' Tests* Mr. Stead adopts, with success, a novel method of showing his readers how to deal with applications for banking accommodation.

F. E. S.

WIMBLEDON,
November, 1925.

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These lectures will not be in any sense formal. They will be a succession of talks about a branch of banking—the lending branch—which happens to have come most under my daily observation.

Every morning, for some twenty-five years, I have found, on arriving at the bank, correspondence on my table relating to loans and overdrafts and discounts at a variety of places—manufacturing, commercial, agricultural, city, residential, seaside—and I have had interviews, every day, with customers of the bank

who desired accommodation in some form. It is the essence of the experience gained in dealing daily with these matters which I have extracted, and shall endeavour to place before you.

THE STANDPOINT DEFINED

One thing rather troubles me. Much of what I have to tell you will be already well known to those who are themselves engaged in the lending department of a bank.

A great deal of it, though by no means all, will, to that section, necessarily be somewhat elementary. This, I fear, cannot be helped. To be elementary, at the outset at any rate, seems to me to be the only possible working basis. If I am to assume a knowledge of the subject, how much knowledge am I to assume? Where am I to commence? Some of you know much about the technique of lending; some of you know less; some possibly know nothing. To which section am I to suit my remarks if I do not begin, at least, at the alphabet of the subject? As I proceed, I shall be less "elementary."

There is further justification for the course I have deliberately adopted in this respect. Banking, especially in large offices, has become a highly specialized business. Hundreds of the employees in our big offices spend most of their time in one or two specialized departments. Some may have considerable banking experience, but not in this particular branch—the lending branch.

May I, in this connexion, refer to my own experience? Out of my first 16 years in a bank, nine successive years—from the age of 25 to that of 34—were spent in checking ledgers every morning and cancelling clearing cheques every afternoon. All I learned during that time (in the bank) was how to

put a red ink tick against an entry in a ledger, and a few things about endorsements, together, of course, with a certain amount of information—useless when I left that bank and entered another—as to the financial position of the bank's customers. I should have been only too glad, either from practical experience or otherwise, of opportunities of learning something about my bank's lending activities.

For these reasons, then—

1. The impossibility, otherwise, of hitting on a common starting point, and
2. The fact that most banking men and women have no opportunity of seeing anything of lending in the course of their daily routine,

I have to begin at the beginning. I am practically forced, if I am to be intelligible, to treat the subject at the outset in an elementary manner; and, for these reasons, also, I feel convinced that those of you who are already conversant with more than the rudiments of the subject will cheerfully put up with this method of treatment for the sake of the "weaker brother."

Moreover (if I am not labouring the point), you will have observed that the ablest textbooks on money and banking adopt this method, and begin with the elements of their subject. Bagehot's *Lombard Street*, Goschen's *Foreign Exchanges*, Hartley Withers' *The Meaning of Money*, are all elementary, and, for this reason, they can all be understood by persons of average intelligence, with no special previous knowledge of their subject matter.

THE HEAD OFFICE POINT OF VIEW

Another point—and here I am conscious that I am on more debatable ground—I shall frankly take a "Head Office" standpoint.

This, I am only too well aware, will not be popular with branch men, who constitute the majority of my audience. A branch man often thinks, and sometimes says, apropos of head office views of lending: "Ah! if only these head office people had to deal themselves, as we do, with borrowers," or "It's all very well for these 'brass hats' to sit in comfortable armchairs at headquarters, and issue instructions, while we face the guns."

I deeply sympathize with this view, and my sympathy with it has been strongest and deepest when I have had, temporarily, to take charge of a branch, and obey head office instructions. But you cannot fail to have noticed that if a would-be borrower be a branch customer, and cannot be brought to see reason at the branch, or if he be a very important person, he is often, and properly, sent up to head office, always, I hope, with due notice of his proposed call and such particulars relating to him and his proposal as the manager possesses. As a matter of fact, head office officials spend much time every day in interviewing borrowers, and in putting to them those delicate, "awkward" questions and suggestions which it is frequently a banker's duty to propound.

So, please, if I venture to make suggestions, as I shall, from a head office standpoint, with regard to lending transactions, I ask you, in advance, not to think you are being asked to do something which one would not dare to carry out oneself; not to imagine that the head office official is, necessarily, like one of W. S. Gilbert's military heroes, who—

> Led his regiment from behind,
> He found it less exciting.

Of one thing, I sincerely trust, I shall not be guilty,

and that is what is known, I understand, at branches as the "head office manner."

THE BANKER'S MAIN FUNCTIONS

Our theme, then, is, the banker as a lender, and in coming to closer quarters with it, may I remind you of the favourite textbook summary, which we get from Gilbart and others, of the chief branches of banking business—

1. **The Exchanging of Money.**

Banking, as you will know, owes its origin to this function, but, until recently, it has been little exercised by modern joint-stock banks.

2. **The Lending of Money.**
3. **The Borrowing of Money**, i.e. the collection of deposits.

This function should, I think, come before the preceding one, because obviously a bank's deposits must be obtained before they can be lent.

4. **The Transmission of Money.**

The second of these is our subject—the lending branch of banking; the most important branch; the most difficult.

The main economic function of a banker is really a double one; on the one hand, to gather deposits, and on the other to lend them, or rather a portion of them, to advantage.

It has been observed that this function remains the same whether it be a case of an old-fashioned, easy-going country bank (if there be such an institution left), a large joint-stock bank with a network of branches, agencies, and correspondents throughout the country and the world, or a pioneer bank in a new country, "with a stock-in-trade consisting of a tent, a safe, a trestle table, and a revolver."

The main function of all these is to get deposits, and, having got them, to dispose of them to the greatest possible advantage of the community and the shareholders. A banker's solvency, his continuance in business; in fact, his existence, and, incidentally, his profits, depend largely on the ability and judgment he displays in this matter of lending.

For this reason, if we could pierce the veil of secrecy which hides the salary records of our banks, we should probably find that those officials who have much to do with lending—controllers, chief controllers, the higher officials of advance and inspection departments and others—are in receipt of the highest salaries. I suggest that the lending officials of a bank bear a relationship to those of their colleagues who deal with the receipt of cash very similar to that borne by the buyers in a wholesale house to those who sell the goods.

The moral of all this, from the point of view of the young banker who aspires to one of the higher and better paid posts in his bank, is to get on the "lending side" of his bank, if he can. Unfortunately, this is one of the many matters as to which, when we commence our banking career and afterwards, we are not consulted.

A BANK BALANCE SHEET [1]

I am going to approach the subject by glancing at the principal items of a bank balance sheet, and this notwithstanding the fact that recently, in reading a novel, I came across a reference to a balance sheet, though not a bank balance sheet, as "the last remaining relic of mystery in a prosaic age"! Let us tackle

[1] Will those readers who may be disposed to "skip" this consideration of a bank balance sheet do the author the favour of reading, first, the paragraphs headed "General Interest of a Bank Balance Sheet," on page 37.

this mystery together, so far as a bank balance sheet is concerned. A clear understanding of the significance of such a balance sheet is absolutely indispensable to the banker as a lender, and, incidentally, throws considerable light on modern banking methods. It is useful, also, apart from this, to every banking man, as part of his technical education. It enables him to judge for himself, and in case of need to give an intelligent opinion to others when they consult him, of the actual strength of a bank, and its relative strength and reliability.

One of the drawbacks of being in a bank is that one's friends and acquaintances are apt to regard one as a financial authority, and I have no doubt that some of you have found it a difficult matter, at times, to sustain the rôle.

May I say that after I had decided to approach the subject by an examination of a bank balance sheet, and had made full notes of this lecture, I was much encouraged, in doing so, by reading in the preface to Dr. Phillips' work, *Bank Credit* (The Macmillan Company, New York), that a preliminary study of a bank balance sheet was strongly recommended to students and bankers desirous of understanding the principles underlying the advances made by banks to borrowers.

To make the matter clearer, I have had placed in your hands a copy of the balance sheet of one of the banks, with the respective ratios worked out in the margin.[1]

In dealing with the various items of this balance sheet, I will begin with the " Liabilities " side of the statement.

THE " LIABILITIES " SIDE OF THE BALANCE SHEET

1. **Capital.** I have even heard the question asked, " How can a bank's capital be a liability ? If I go

[1] See page 8

A TYPICAL BANK BALANCE SHEET

Liabilities	£	s. d.	Assets	£	s. d.	Ratio to Current, Deposit & Other A/cs. %
Capital— Registered £33,000,000 Subscribed £30,264,688 Paid-up	9,051,718		Coin, Bank and Currency Notes and Balances with the Bank of England	27,997,318		10·7
Reserve	9,051,718		Balances with, and cheques in course of collection on, other banks in Great Britain and Ireland	9,500,473		3·6
Current, Deposit and other Accounts	262,328,585		Money at Call and Short Notice	25,964,155		9·9
Liabilities for Acceptances, Endorsements, etc., as per contra	11,822,641		Bills Discounted	39,126,584		14·9
Notes in Circulation	14,892		Investments	50,292,215		19·2
			Investments in Affiliated Banks	2,991,706		1·1
			Advances to Customers and other Accounts	120,390,283		45·9
			Bank Premises Account	4,184,179		
			Liabilities of Customers for Acceptances, Endorsements, etc., as per contra	11,822,641		
	£292,269,554			£292,269,554		

into business with capital, isn't my capital an asset ?"

The reply to the last question is, "It is." But it is also the difference between my assets and my liabilities, and as my assets exceed my liabilities (or should exceed them) the difference is placed on the liabilities side, in order to balance the total of that side with the total of the "assets" side.

The reply, in the case of a joint-stock bank or other similar company, is, in a sense, the same. The amount of the capital, plus the reserve and the balance of the profit and loss account, equals the difference between the assets and the other liabilities. A very easy way in which to appreciate the reason why the capital of a joint-stock bank is placed on the "liabilities" side of its balance sheet is to realize that the bank is a concern which has certain liabilities to its shareholders for the cash which they have put into the business in the form of capital, just as it has other liabilities to its customers and depositors for the money which they have lent to it in the form of deposits. In this sense it is a genuine liability and not merely a "difference."

There is one point worth noting about this item "Capital." There was supposed, not long since, to be a fairly definite relation between the amount of the paid-up capital, together with the reserve fund of a bank, and the amount of its deposits. This, nowadays, owing to the abnormal growth of deposits due to the Great War, is a counsel of perfection; a "pious opinion" rather than a matter of actual practice. Banks have increased their capital to some extent in many instances since their deposits so greatly increased, but the old idea of a fairly definite and satisfactory ratio between capital and deposits has, like so many other theories during and since the

War, to a great extent gone by the board. In 1900 the capital and reserve of the banks of the United Kingdom bore so high a proportion as 14·7 per cent of their liabilities. In 1913 the proportion was 11·5 per cent, but it has recently been so low as 6·08 per cent.

A further feature to note, as regards the ordinary type of joint-stock bank, is that the full amount of the capital is not paid up. Part of it—the unpaid part—is a contingent liability on the part of the shareholders.

This unpaid part of the share capital, however, is divided into two portions. One part is what is known as "reserve liability," and is callable only in the event of the bank being wound up. The other part may be called up for the ordinary purposes of the business under certain conditions laid down in the Articles of Association.

In the balance sheet which has been placed in your hands, for example, the shares, apart from a comparatively small number of fully paid shares of £1, are of a denomination of £20 each. Of this £20, £5 is paid up, £5 may be called up by the directors under certain prescribed conditions, and £10 is "reserve liability," and can be called up only in the event of a winding up of the business.

I offer no apology for calling attention to this point. I feel sure that you all have a few colleagues who are unaware that the uncalled capital of their bank is divided into two categories, or, if aware of this, could not tell you what proportion of the unpaid capital is reserve liability and what proportion comes in another category. Please, however, do not put this to the test by asking the question broadcast to-morrow at your branch. Such a course would not tend to increase your popularity in the office.

The fact that the shares are not fully paid affords, of course, a measure of security for the depositor. If the bank got into difficulties, and its assets, on realization, proved insufficient to meet its liabilities, the shareholders would be called upon, up to a point, to meet the difference.

COMPARISON WITH GERMAN BANKS. Contrast this position, as regards the contingent liability of the shareholders, with that of the big German banks; for example, with that of the Deutsche Bank, the Dresdner Bank, and the Direction der Disconto-Gesellschaft, the whole of whose capital is fully paid, and, judged by pre-war standards, was somewhat larger than the paid-up capital of our leading commercial banks.

One can easily realize how, before the War, a greater lending power was conferred by this characteristic of the leading German banks.

The fact that their capital was fully paid enabled them, with propriety, to make some advances of a kind which British banks, with their smaller and not fully paid-up capital, could not prudently make.

The German bank, having more of its own funds to lend, had not to keep its advances, as a whole, so liquid as an English bank, whose advances were, to a greater extent, made from other people's money: money deposited by customers and repayable on demand or at short notice. In short, a banker or anyone else can lend more freely when he is lending his own money than when he is dealing with the money of others.

Hence, the German banks, before the War, could and did assist business enterprises by taking, for a time, blocks of shares in those enterprises, and in other similar ways.

This, however, is by no means an unmixed advantage to a banker. True, it enables him, should he choose to do so, to " tie-up " his funds (or part of them) more, but it has often led him to deviate from the path of safety, or (to revert to the previous expression) to tie-up part of his funds so tightly that he has been unable to untie them, and has had to cut the knot, and cut a loss with it.

This, in the case of the German banks, is not a mere theory or possibility, but an actual experience in the economic history of Germany.

2. **Reserve.** Again the question, " Why a liability? Surely a bank's reserve fund is an asset." I see, by the examiner's report on the papers of candidates in the Practice and Law of Banking examination of the Institute of Bankers, that many of the candidates failed to realize that a bank's reserve funds are a liability and not an asset; that it is a sum which the bank, in a sense, owes to its shareholders. I cannot do better than quote Dr. Phillips' *Bank Credit* with regard to this point: " Bank surplus is a liability of the bank to its shareholders which arises from and represents the excess value of assets over and above that required to meet all other liabilities, including capital stock and undivided profits."

It is the ambition of every well-regulated bank to bring the amount of its reserve at least up to the amount of its paid-up capital. This for several reasons. Every addition to reserve adds to the bank's strength; gives it something further to fall back upon in case of a loss, and (being employed in the business) adds to its earning capacity. In the particular balance sheet which you have in your hands, you will observe that the amount of the reserve is equal to the amount of the paid-up capital.

You will be well aware how a bank's reserve is built up: partly by the premium on fresh issues of shares made from time to time, partly by means of allocations made periodically in good years from profits.

As to the function of a reserve (apart from its being a source of profit), while it remains, it is, in the main, a fund on which the directors of the bank can draw in the event of exceptionally heavy losses having been incurred. Well conducted banks do not hesitate, in case of need, to draw on their reserve fund if very heavy losses have to be met, although I need not tell you that, for obvious reasons, this is a course which they endeavour, if possible, to avoid.

3. **Current, Deposit and Other Accounts.** Little comment on these is necessary, except that one always wishes, for obvious reasons, that one knew what proportion of the money lodged is on current account, and what proportion on deposit at notice. The "other accounts" include the balance of the bank's profit and loss account, the item "Rebate"—discount received but not yet earned—and the bank's "Contingency Fund." The first two of these items used to be stated separately, but they are now included by this bank and certain others in the heading "Other Accounts." Some banks define the nature of this item a little more closely in their balance sheets by means of the heading "Current, Deposit, and Other Accounts, including Provision for Contingencies."

4. **Liabilities for Acceptances, Endorsements, etc.** This is a "cross entry," as you will see from the other side of the balance sheet, where exactly the same amount appears under the heading "Liabilities of Customers for Acceptances, Endorsements, etc."

It is not, however, to be airily dismissed by the

statement that it constitutes a "cross entry." Let us look at it more closely, taking it backwards.

(*a*) Endorsements. A customer of the bank has a foreign bill—a bill payable abroad—and wants to turn it into cash. Had it been an English bill, he would have discounted it in the ordinary course. As it is foreign, he gets his banker to "negotiate" it, that is, his banker buys it from him, "with recourse"; endorses it, thereby ensuring its ready saleability at a fine rate, and sells it to a foreign bill dealer.

A bank which has a foreign department, and which itself conducts foreign business, does not by any means necessarily or usually adopt this course. It may do so in the case of bills on certain colonies or countries, for special reasons. Or it may use the bill as a means of replenishing its currency balance in the country in which the bill is payable. There is no need to go fully into this, however. The explanation given above will suffice to indicate the meaning of this item.

Hence, also, the appearance of an equivalent amount on the "assets" side of the balance sheet—"Liability of Customers for Endorsements, etc." The banker, by reason of his endorsement, has incurred a liability, but he still has the liability of his customer to fall back upon.

(*b*) Acceptances. This is a more interesting and significant item. It opens up the whole subject of the rôle played by the banker in financing imports.

Illustration of "Acceptances"—the Financing of Raw Cotton. Concrete instances are always easier to follow than abstract statements. I shall, therefore, take the case of the import of raw cotton as illustrating this item in a bank balance sheet.

Incidentally, it is worth while going into this, for in two of the balance sheets which I have before me

the item "acceptances" amounts in one case to £23,700,000 odd; in the other to £32,000,000 odd. In the balance sheet of which you have been supplied with a copy, this item happens to be considerably smaller.

I will not take you back to the earliest stage of the financing of cotton; the stage when the cotton is growing and being gathered; although in some ways the financing of this is the most interesting stage of all. This financing, however, appertains to American and Egyptian banking; it is not a matter for us. I will begin at the stage when the cotton is packed ready for export, because it is then that the banker on this side begins to be financially interested in it.

May I say here, parenthetically, that I have dealt with this particular class of imports, but less fully, in my *Present-day Banking* (Butterworth & Co.), in which the financing of other imports and various kinds of exports is also explained.

It is possible that a Liverpool cotton importing house is represented in one of the cotton centres in the United States by a partner or agent.

It may be, on the other hand, that the Liverpool house is not directly represented; that the cotton is sold by the merchant in the town in the southern States on sample, or standard description, the importer on this side believing, from his experience of previous transactions, that he can safely rely on the exporter to ship the right stuff, as to staple, grade, etc.

In this matter of exports, the main thing, at this stage, from both the exporting and the banking point of view, is to get the produce represented by some kind of document. Until it is so represented, it is difficult for the banker to deal with it.

The first object, then, of the representative, in the

cotton centre, of the Liverpool importing house or of the American exporter, is to get the cotton placed in the hands of the railway company, and he will then receive a railroad receipt exchangeable for an ocean bill of lading or a " through " bill of lading.

Directly he gets one of these documents he is able to go ahead. He draws a sterling bill of exchange on a Liverpool bank, by arrangement, and to this bill of exchange he attaches certain subsidiary documents: the bill of lading, a copy invoice, and insurance certificates, covering not only the risk of fire and the usual marine risks, but such risks as that which may, even yet, arise from floating mines. He then goes to the local banker, to whom he gives a letter of hypothecation over the cotton, and the banker, in exchange, gives him cash which will enable him to continue his operations. In other words, he negotiates the draft.

As to the further history of the draft, there are several courses open to the banker in the southern centre.

It is open to him to forward it, with the accompanying documents, to his agent in London or Liverpool, but, as a matter of practice, it is not often that the southern bank in the States negotiates direct on England. The tendency is for New York, Philadelphia, or some other financial centre in the States to attract such remittances. Perhaps 90 per cent of cotton drafts drawn in the manner indicated go north to one of the financial centres. Those of you who see such bills in the course of your business will know this, because the bills bear evidence of the channels through which they have been negotiated.

Whichever course is adopted in the matter of channel of negotiation, the agent in this country of the American bank which has carried through the negotiation presents the draft to the bank in Liverpool

on which it is drawn, and the Liverpool bank, on the instructions and responsibility of its importing customer, accepts it " payable in London." I emphasize that this is done on the responsibility of the customer, because this illustrates the meaning of the entry on the other side of the bank's balance sheet—" Liability of Customers for Acceptances."

When the Liverpool banker accepts the draft, he detaches and retains the documents which accompany it. These documents are documents of title to the cotton, and it is reasonable that the accepting banker should retain them, because he has made himself liable for the payment of the relative draft at maturity, and the cotton represented by the documents forms, in a sense, his security, and if the customer does not provide cash in time to meet the bill at maturity, the banker has the right to sell the cotton and thus recoup himself for having paid the acceptance himself. In practice, the bank sells the cotton only when the importer has publicly defaulted.

To revert, the cotton arrives in Liverpool, but the firm to whom it has been consigned cannot handle it until it gets possession of the documents of title—either bills of lading or, at a later stage, warehouse receipts, these documents being, as we have seen, held by the banker as " cover " for having given his acceptance to the draft.

Theoretically, if it be a cotton broker who applies for the documents to enable him to deal with the cotton, it is to the broker that the bank delivers the documents, against the broker's undertaking to do one of two things : if not sold, to store the cotton in the bank's name in an independent warehouse ; if sold, to hand the proceeds to the bank within the customary period—10 days.

I say "theoretically" because, of late years, the functions of merchant and broker have so merged that most cotton importers can now, for this purpose, safely be constituted the bank's brokers in this matter.

This will show you one of the ways in which this item "Acceptances" in the balance sheet originates, and inasmuch as the banker, until the bill is paid, retains recourse on the other parties to the bills, it explains the corresponding entry on the other side of the statement.

Credits. Another kind of transaction which tends to swell this item "Acceptances" in a balance sheet is the granting of acceptance credits by bankers in this country for the purpose of facilitating imports.

Transactions of this sort are pithily defined by Mr. Spalding, in the chapter on Credits towards the end of his most useful treatise, *Foreign Exchange and Foreign Bills* (Pitman). I will give you his definition of a confirmed credit, leaving you, if you are desirous of informing yourself as to the nature and operation of other forms of credit, to turn to the book itself or to his work, *Bankers' Credits* (Pitman). Confirmed credits are described as "credits opened by a banker, setting forth certain conditions and stipulations under which he agrees to accept the bills drawn by a foreign shipper, as and when presented to him, up to a certain specified amount." Mr. Spalding adds, "this document is largely used in financing foreign trade, which need not necessarily be confined to this country. Although the credit may be opened from London, it may refer to shipments from the foreign country to continental centres."

The magnitude of this item "Acceptances" varies greatly. It is much lower, as a rule, in the summer. It expands in the winter because, in the main, it is in

the winter that the season for the import of staple commodities is at its height. In the early autumn, the amount of such acceptances is usually quite small. About the end of the year it is, speaking generally, at its highest. In the spring it is again greatly reduced.

The advantage, to a banker, of increasing his acceptances is that it enables him to give accommodation without, as a rule, making cash advances. Sometimes, when a cash advance is asked for and it is not convenient to grant it, the transaction for which the accommodation is required is of such a nature that the bank may, with propriety, afford the accommodation by giving its acceptance to bills, such bills being then discounted in the market at fine rates and the customer being thus put in possession of the funds he needs without having inconvenienced his banker by taking a large cash advance. Needless to say, this is not done in the case of home transactions.

5. Notes in Circulation. This is a dwindling and negligible item in most instances, owing to wholesale amalgamations between provincial banks which enjoyed the privilege of issuing notes and London banks which did not enjoy that privilege. The trifling amount of "Notes in Circulation" in the balance sheet before us will be recognized as an exceptional case.

Items Sometimes Stated Separately. In some bank balance sheets one sees, separately stated, the item "Rebate on Bills Not Due." This represents the amount received by the bank from customers in the form of discount but not, at the time when the balance sheet is made up, actually earned, because some of the bills on which the discount has been charged have not yet matured. It represents, as stated a little earlier, discount received but not yet earned.

The item "Balance of Profit and Loss Account,"

which, in the balance sheet before you, is included in "Current, Deposit and Other Accounts," is also sometimes given separately. It represents undistributed profit, and is generally the amount left over after providing for the dividend, writing down investments, and adding to the Reserve Fund.

This completes our study of the liability side of the balance sheet, and leaves us free to turn our attention to the assets side.

THE "ASSETS" SIDE OF A BANK BALANCE SHEET.

This side is, in some ways, more important, and is therefore worthy of close examination.

The "Assets" items in a bank balance sheet are arranged in order of liquidness. The more liquid ones come first—beginning with cash; whilst the item "Premises," being the least easily realizable, is usually placed last, or practically last. In the balance sheet in your hands it is the last item, with the exception of a cross entry.

1. **Coin, Bank and Currency Notes, and Balances with the Bank of England.** The bank's first line of defence in time of trouble is, obviously, this item, sometimes stated as "Cash in Hand and at the Bank of England," and the first test of the strength of a bank's position lies in the answer to the question, "What proportion does this item bear to the bank's liabilities to the public?"

There are various methods of dealing with the proportion borne by the several items of a bank balance sheet to certain other items.

One method is to take the proportion of the assets items as between themselves. Taking the total assets at 100 per cent, to ascertain what proportion each

separate group of assets bears to the assets as a whole: cash so much per cent, investments so much per cent, and so on.

This is a useful method for certain purposes, because it brings out a figure the significance of which is not obscured by extensive variations in the amount of the liabilities. On the other hand, what one desires to bring out, in an inquiry into the strength of a bank, is, after all, the extent to which its assets, and particularly its liquid assets, are sufficient to meet its liabilities.

Another method is to work out the proportion borne by the several items of the assets to the total liabilities to the public, such liabilities including the acceptances. This is a method frequently adopted, and it is useful for some purposes, but it has one considerable disadvantage, inasmuch as the amount of the acceptances fluctuates very greatly, as we have already noticed, at different seasons of the year, and this obscures the significance of an alteration in the amount of a particular item of the assets. Moreover, the acceptances are, as we have seen, really a "cross entry."

The method I have adopted for the present purpose is simply to take the proportion of the several items of the assets to the item "Current, Deposit, and Other Accounts," this being the really vital matter. What one wishes to know is to what extent, for example, the cash held by the bank is sufficient to meet the possible demands of those who have deposited their money with it.

I recommend you to turn over in your minds the relative advantages and drawbacks of each of these modes of dealing with percentages in connexion with bank balance sheets. It will be worth your while. It is not without careful consideration that I have

adopted this mode, and it is not without full consciousness of its drawbacks. I do not say it is the best method. I adopt it because, on the whole, it is the most conducive to the attainment of the object I have in view—the testing of the strength of the concern.

Proportion of Cash to Deposits. Coming back from this pertinent digression to the question of the proportion of cash which a bank should hold, I observe that in the balance sheet before me that proportion is 11·3 per cent. One hesitates to lay down any general rule, but it may be remarked that one of the latest statements of the proportion of cash to deposits of the ten London clearing banks shows this proportion to be 11·6 per cent. In another such statement now before me the proportion varies, in the case of different banks in this group, between 15·2 and 8·9. Anything from 10 per cent upwards may be regarded as sufficient for practical purposes.

2. **Balances with, and Cheques in Course of Collection on, other Banks in the United Kingdom.** This is an item of the balance sheet which needs no explanation or comment, as it speaks for itself. The proportion which it bears to the deposits is, as you will observe from the balance sheet in your hands, 3·6 per cent, and a part of it, at least, may be regarded as cash.

Until comparatively lately, the whole of this item was included, in the balance sheets of the banks, in the cash.

3. **Money at Call and Short Notice.** This item represents money lent to the money market—the bill brokers and discount houses, and, to a smaller extent, to members of the Stock Exchange "from account to account." I shall go fully into this item in a later lecture. Meanwhile, it may be noted that every bank has deposits which may be withdrawn, and

that to provide for the possibility of their withdrawal at short notice the cash actually in hand and at the Bank of England is not enough. On the other hand, the cash in hand and at the Bank of England is earning no interest, and the point arises, how is the bank to be prepared for an emergency, to keep further resources very liquid and "get-at-able," and yet not to have an unduly large sum unprofitably employed? This is where the money market comes in. The bill broker will take large sums repayable in a week—"fixtures." He will take considerable sums which he is prepared to repay at a day's notice—"day-to-day money"; money which, if not called in by the banker before noon, is at the broker's disposal for another day; and he is, at times, glad to borrow money for one day only.

The advantage to a banker of lending considerable sums to the money market is that he gets a fair rate of interest on such money, and yet can get it back in case of need at exceedingly short notice, much of it "at call." This is the main advantage of a banker's "money market" money; it is easily and readily available.

You will remember Glendower's boast in Shakespeare's "Henry IV":

> I can call spirits from the vasty deep;

and Hotspur's reply:

> Why, so can I, and so can any man,
> But will they come when you do call for them?

A banker's funds, lent to the money market, can stand this highly practical test, as has often been proved. They will "come when you do call for them."

This, however, is a matter which will be dealt with

more fully in a later lecture of this series, that on *The Banker as a Lender to the Money Market*. Attention is directed to it here merely in connexion with a bank balance sheet.

The proportion of call and notice money to the total liabilities of the banks has varied greatly during the last eleven eventful years. In a series of balance sheets before me that proportion has varied between 4·4 per cent and 17·7 per cent, the latter figure being the percentage shown in 1917.

An explanation of the high ratio which has been shown at times during the period in question is to be found in the fact that, during a part of the War period, the banks lent large sums to the Bank of England at interest at three days' notice, and such sums were, of course, included in the total of money at call and short notice.

An explanation of the low ratio which was shown for some time after the Armistice is furnished by the greater demands of commerce and industry for accommodation. Funds were transferred from "Money at Call and Short Notice" to "Advances to Customers" because of the need for financing trade and industry. It was assumed, in many quarters, that the fall in the amount of money lent out at call and short notice during the period in question was due to the withdrawal of funds from the discount houses, but the assumption was not justified by the facts. It was mainly due to withdrawals of "short money" from the Bank of England.

As before mentioned, the proportion, in this case before me, is down to 7 per cent. This is the bank's second line of defence, and, with cash 11·3 per cent, gives a total, for cash and money at call and short notice, of 18·3 per cent. So that, if called upon to

repay its depositors, this bank could pay off over a ninth of them at once, from its actual holding of cash, and, in a week or less, between a fifth and a sixth of them, from these two sources alone.

4. **Bills Discounted.** This item follows immediately after the two cash items by reason of its highly liquid nature. A bank has only to allow the bills in its portfolio to mature, and they will bring in, daily and automatically, large sums in cash.

I need not tell you that, in the books of the bank, the bills discounted are classified more in detail. They are not all "lumped together," as they are in the balance sheet. If the books of the bank are kept as they should be, there will be at least three sub-headings to the heading "Bills Discounted," namely, Treasury bills, bank and commercial bills, and foreign bills. For balance sheet purposes it is not necessary that inland and foreign bills should be shown separately, but it would be of great advantage to financiers and journalists and others whose business it is to analyse these statements from time to time if the amount of the Treasury bills was stated separately from the amount of other bills. One of the methods of estimating the strength of a bank is to take the proportion borne by its advances plus its discounts to its total deposits, and when the amount of the Treasury bills is included, with the commercial bills, in one total as "bills discounted," such a comparison is comparatively valueless, since it is obvious that the Treasury bills, although technically they are bills discounted, are really more in the nature of an investment. In the case of some banks, the total of the Treasury bills held considerably exceeds the total of the commercial bills, and their inclusion in the general heading "bills discounted" entirely vitiates the value of any estimate of the

strength of the bank into which the total of bills discounted, as shown in the balance sheet, enters.

I shall not, at this stage, go into the process of discounting. That will, if necessary at all, come later. Here, we are mainly concerned with proportions. In the present instance, the proportion borne by bills discounted to deposits is 24·6 per cent.

None of the commercial bills represented by this item "Bills Discounted" in the balance sheet has more than six months to run; most of them will mature within a much more limited period. No self-respecting banker in these days would think of discounting bills maturing at a longer period than six months, although, of course, he would be willing, if his customer desired it, to hold them "short."

We have, then—

	Per cent
Cash (actually in hand or at Bank of England)	11·3
Money market money (all recallable in a week or less)	7·0
Bills under discount, running off and turning into cash daily	24·6
Total	42·9

of the bank's total deposits with which to meet possible demands for cash.

A bank's "Bills Discounted" constitute its third line of defence in the event of trouble arising. The banker has only to "hold his hand" in the matter of further discounting, and his stock of cash will be replenished daily from the proceeds of his maturing discounts.

5. **Investments.** This item is distinctly less liquid than the three items which we have just dealt with. The state of affairs which causes a "run" on a bank is, generally, not favourable to the realization of its investments. It is probable that, in such a contingency,

the bank on which there is a "run" will not sell its securities, but, rather than realize them at a heavy loss, will offer them to the Bank of England as security for an advance.

In estimating the strength of a bank, the element of quality comes in in connexion with this item, as it does also, of course, to some extent in the case of the previous item. It is not enough that a bank's investments should be fairly saleable and that they should bear a proper proportion to the amount of its liabilities to the public. They must be of such a nature and quality that they can be realized in a very short time.

Many bank failures have afforded evidence of this. The "proportion" position has been quite passable. It has been the nature, both of its investments and its advances, which has been at fault.

I well remember, over thirty years ago, being present at an examination, behind closed doors, of the investments and advances of a provincial bank, with a view to amalgamation. The general manager of the bank in question read out a list of investments—Consols, India Threes, etc.—and eventually he came to an item "six freehold cottages." At this those of us who represented the "absorbing" bank naturally pricked up our ears, and, noticing this, the explanation was given that the cottages had originally been taken as security for an advance, and that, the borrower having failed, the bank had entered into possession of them, and that inasmuch as they were let at fair rentals, the directors of the bank felt justified in including them in their investments. This explanation was met by our chief representative with the chaffing remark, "Ah, I see, involuntary investments!"

I am betraying no confidence in mentioning this small

incident. For other reasons, we did not take over the bank in question, and more than twenty-five years ago it found a home with another bank. The property in question was doubtless saleable, at a price, but not at short notice, not easily; otherwise the bank would have realized it before, and for this reason it should not have been allowed to appear in the highly select company of Government securities.

The proportion borne by the item "Investments" in the balance sheet before me is 19·2 per cent. Very great changes were shown in this proportion during the War, for the reason that the banks repeatedly took blocks of stocks issued by the Government for the purpose of prosecuting the War. The result was that the proportion shown by this asset was much higher than the banks could have wished. In the balance sheets for the last twelve years of a typical bank I see that the investments, which at the end of 1913 stood at 9·5 per cent of the deposits, rose at one time during the War to 31·2 per cent, or nearly one-third.

Of course, the actual amount of the bank's investments did not vary so much as these figures would appear to indicate. It was the proportion of investments to deposits which varied thus. It may also be observed that it was mainly the growth of the deposits which caused the proportions to dwindle again as they did. Still, the variations in the proportion are significant. It may be of interest to you to know that, for the average of the three years 1922, 1923 and 1924, the percentage of advances *plus discounts* to the deposits of the London Clearing Banks was the same as that shown, by the same banks, for the average of 1911, 1912 and 1913, so we have returned to "normalcy" in one respect. The proportion was 63 per cent.

One result, as regards the lending capacity of the

banks during the period when the total of their investments was unduly high during the War and for a time afterwards, is significant. A customer, we will say, required further capital for trade purposes. He had, himself, a large holding of War Loan, subscribed for from patriotic motives, and did not wish to realize, because realization meant loss. He applied to his banker, who, if he happened to be "fully lent," would himself have had to sell part of his holding of War Loan at a loss in order to give the needed help. Such cases, however, are happily a matter of history only.

You will doubtless observe that the investments of a bank are not, as a rule, lumped together in the balance sheet. They are generally subdivided.

1. War loans and other securities of, or guaranteed by, the British Government.
2. Indian and Colonial Government securities.
3. Other investments.

Here, again, the most liquid items are placed first.

6. Investments in Affiliated Banks. Shares, that is, in banks of which the bank is owner, or part owner; of which it holds all or a proportion of the shares.

This tendency for a big bank to become the "predominating partner" in another bank operating in a different area is a characteristic of quite recent years. At first we had amalgamations, pure and simple; the blending into one of two or more businesses. Now the course frequently taken is for the bigger institution to secure the shares in another bank operating in another part of the Kingdom, in the Colonies, or in foreign countries, this other bank retaining its identity, its machinery, and, in the main, its *personnel*.

As a rule, the names of the banks the shares of which are thus held, and the number of shares held in each,

are given in the balance sheet, and when the balance sheet of the "holding" bank is sent to the shareholders a balance sheet of each of the subsidiary banks is sent with it. This is as it should be. As the shares of the subsidiary banks are represented in the main balance sheet as assets, it is only fair that the shareholders of the parent bank should have the opportunity of estimating, so far as a balance sheet will enable them to do so, the value of such assets.

An occasional criticism of this comparatively novel item in a banker's balance sheet is that inasmuch as the shares which appear in this way as an asset carry with them, as a rule, a contingent liability, it is not strictly regular to regard them, for balance sheet purposes, as a pure asset. Strictly regarded, they are a "mixed" asset; an asset which might, in conceivable but improbable circumstances, prove to be a liability.

7. **Advances to Customers and Other Accounts.** These advances, I need scarcely tell you, are quite distinct from, and are in addition to, advances to the money market. So far as the liquid position of a bank is concerned, many of these advances mature, or can be called in, within a very brief period; those against Stock Exchange securities, for example. Others would take more time before they could be got in.

The proportion of this item to the total liabilities is the most important to the lending bank and is the figure most frequently and carefully watched. In this instance it is 37·6 per cent only, but if to the amount of advances we add the amount of the discounts, which was 24·6 per cent, the resulting proportion, 62·2 per cent, is well above one-half of the total amount of the liabilities. One has, however, in considering this proportion, to remember that the "discounts" are sure to include a heavy amount of Treasury bills.

It is quite possible that if the total of such bills were omitted, the proportion borne by the commercial discounts plus the advances would not exceed about 50 per cent of the deposits in this case.

How a Due Proportion is Maintained. Now when a banker has come to a conclusion as to the correct proportion for his bank between the amount of his advances on the one hand, and the amount of his liabilities on the other, what steps does he take to see that that proportion is not exceeded?

Well, the chief manager of the bank has before him every morning a book which gives him the fullest information available with regard to the financial state of the bank as regards certain important items. He also has before him, at very brief intervals, particulars of the amount of the advances and of the proportion which that amount bears to the bank's deposits. If the demand for accommodation tends to be greater than, with a due regard for the proper proportion between the amount of the deposits and the amount of the advances, he can prudently satisfy, he acts accordingly. He looks round for long-standing advances which should be called in, and he discriminates, and instructs his chief officers to discriminate, when applications for further large advances come forward. Amongst these will be some which he feels bound to grant. These he grants, relying on the repayment, in the ordinary course, of other advances. There are others which, though perfectly safe, are not pressing; perhaps they are of a speculative or semi-speculative character. With regard to these, he feels that he has discretionary power, and he may elect to decline or defer them, or to whittle them down. To grant them in full would be to exceed the proportion between the amount of the bank's liabilities and the amount of advances which

his experience has taught him constitutes a safe ratio.

This supplies the answer to the complaint which used to be frequently heard, that the banks were not affording the public as much accommodation as they required. In such cases what would-be borrowers ignored or overlooked was the fact that a banker, in view of the interests of the depositors as well as of the shareholders, cannot (*not* will not) lend out more than a given proportion of the funds at his disposal. As the chairman of one of the Scotch banks recently remarked at the annual meeting of the bank, "Those responsible for the policy of a bank have to adhere to the root principle of sound banking—the maintenance of a liquid position, having regard to a banker's obligation to repay deposits on demand."

It is impossible to lay down any hard and fast rule as to the correct proportion of advances to deposits. It varies in different places and in different conditions. In newly-developed countries, the proportion of advances tends to be larger, owing to pressing and insistent demands for banking accommodation. In those parts of "old" countries (agricultural parts of England, for example) where commerce and manufacture are sluggish, this item will be comparatively small, and investments will be comparatively large. Each bank has to decide for itself with regard to this proportion—advances to liabilities. Our most conservative newspaper sometimes refers to 50 per cent as about the right proportion in the case of the big joint-stock banks, but this figure is, in some instances, somewhat too conservative. Slightly over 50 per cent may safely be lent, especially in times of genuine trade activity. In a balance sheet before me the proportion has varied during the last twelve years from

39·5 per cent to 64·2 per cent. This considerable variation is due to the lessening of the demand for advances during the War and to the increase of such demand which took place soon after the War ended.

You are all aware, from your own accounts, that during the War many industrial and agricultural customers who used, in pre-war days, to borrow large sums, had, instead, equally large sums to their credit, and that, after the Armistice, some of these customers began to borrow largely again.

One further point is worthy of remark in considering this question of proportions. In seaports like Liverpool, Bristol, etc., the proportion of advances tends to be high during the importing season, when cotton, corn, and other staple commodities come in from the United States and elsewhere, and are financed, for the time being—until they are both sold and paid for—by the banks, but, in qualification of this, it should be noted that certain staple imports are financed, as we have already seen, not by means of cash advances, but in the form of bank's acceptances.

The proportion of advances to deposits shown by the published figures of the banks throughout the country is one of the generally recognized barometers of the state of trade.

Loans and Overdrafts. Although not separated in the balance sheet, bank advances are of two kinds, loans and overdrafts. You are all well aware that, as a general rule, borrowers in London take advances in the form of loans. They keep a credit balance on current account, and when they take an advance take it in the form of a separate loan.

The provincial practice is, generally speaking, different. In the midlands and the north, for example, and elsewhere in the provinces, advances to customers

largely take the form of an overdraft, which fluctuates within an arranged limit (or should do so). At times the account may be to credit, often for considerable periods. At other times it will be lightly or heavily overdrawn.

What bankers like to see, in the case of such accounts, is elasticity of working; what is known as "a good swing," that is, the account by no means always overdrawn to the full extent of the limit, but fluctuating and always within the limit. This shows that the accommodation given is for the purpose of providing not "fixed" capital, but floating capital, which it is the banker's function to find.

In the case of these advances by way of fluctuating overdraft, the banker loses the advantage which, under the Metropolitan system, is derived from the free use of the current account balance, but this is compensated for, or is supposed to be, by a small percentage charge or commission on the turnover; that is, on the amounts withdrawn.

Each system has its advantages, one advantage of the "overdraft limit" system, from the borrower's standpoint, being that interest is paid by him only on the amount which he actually requires from day to day.

From the lender's point of view, it is a moot point whether it is more profitable to him to have, as under the London system, the use of the current account balance, plus the interest on the fixed loan, or, as under the provincial system, the commission derived from a charge of so much per cent on the turnover, plus the interest on the fluctuating overdraft.

An exact estimate of the comparative advantages of the two systems of lending is very difficult, amongst the uncertain factors being the magnitude of the credit balance on the one hand and, on the other, the amount

of the turnover, the average amount of the cheques drawn, and the amount of the commission.

On one point, it may be a consolation to those of you who are Londoners to know, there can be no doubt. The quarterly or half-yearly balancing of your ledgers, strenuous as it undoubtedly is, is less exacting than that of your less fortunate provincial colleagues who, working the borrowing accounts by way of overdraft, have additional columns in their ledgers for daily "decimals," and have to "convert" these decimals when the books are balanced—not necessarily the whole of the "decimals" for the quarter or half-year, but at least the last of such items.

The Quality of a Bank's Advances. In this matter of advances, as in the case of investments, it is not only the proportion which such advances bear to the deposits, but the quality of the advances, which is a matter of great importance. This, obviously, is not an element which enters into the item "cash"; nor should it enter into the item "money at call," etc., for a loss under this head is exceedingly rare, but it does enter into the items "bills discounted" and "advances."

When an amalgamation is contemplated, one of the first things to be ascertained is the safety and the liquid nature of the advances made by the other bank. One of the most educative experiences in the matter of advances is to be present at a private meeting of representatives of the institutions which propose to amalgamate; to ascertain what the security for the advances is; to hear the explanations of the lenders (sometimes subtle and ingenious); and to form a judgment as to both matters, keeping all the time a running note of the amount which should be provided for possible or probable bad debts.

The addition of the words "and other accounts" after "Advances to customers" covers certain overdrawn impersonal accounts and other items of small importance which do not call for special comment here.

8. **Bank Premises.** This item comes almost at the end, because it is the least liquid. It is the policy of banks to write this item steadily down, the idea being that all the assets shown on a bank balance sheet should be as liquid as possible. In the case of the Bank of England, the item "Premises" does not appear in the statements of assets and liabilities at all.

9. **Liabilities of Customers for Acceptances.** As already noticed, this is a cross entry, calling for no special notice here, having been somewhat fully analysed when we dealt with the liabilities.

Tests of a Bank's Strength. The tests of the soundness of a bank's position, then, are—

1. The quality of its loans and its investments.
2. The proportion of its cash, in hand and at call, to its liabilities.
3. The proportion of its advances to its liabilities.

If amalgamation be the object in view, there are other considerations to be borne in mind.

(*a*) Has the bank "starved" its premises? If so, the "taking-over" bank will have a lot of leeway to make up; will have to spend considerable sums in enlargement and in decoration of the neglected buildings.

(*b*) Does it pay the members of its staff adequately? If not, it may be an expensive matter to place their remuneration on a proper basis. This, too, unlike the last, is a liability which will, to a certain extent, recur annually.

(*c*) Is its earning capacity fairly free from fluctuations due to the prosperity, or otherwise, of a particular

industry? Some banks operate in a limited area, the prosperity of which depends largely on the prosperity of a single staple industry. It is not, generally speaking, wise in considering whether such a bank shall be taken over, to negotiate on the basis of a "profit-showing" statement made out when this particular industry is flourishing. Due allowance should be made for "lean years," which are fairly certain to come.

Incidentally, this last consideration is one of the arguments for the policy of amalgamation, though it is one which is rarely heard. The shareholders of the "absorbed" bank in a "single industry" district, if profits have been divided "up to the hilt," would have had a poor time if the staple industry of their district had been depressed, whereas, when the small bank becomes part of a large one, the depression in its one industry may be, and often is, counteracted, as regards dividends to the bank's shareholders, by the prosperity of another area of the extended sphere of the operations of the amalgamated bank.

I am not, here, defending amalgamations. I am simply pointing out some considerations in connexion with them which may easily be overlooked.

General Interest of a Bank Balance Sheet. So far, I have analysed and commented on a bank's balance sheet largely, though by no means entirely, from the lending standpoint. There are other standpoints, of greater general interest, and for this reason, as well as from the purely business point of view from which we have scrutinized them, I venture strongly to recommend you to analyse some balance sheets for yourselves, beginning, say, with that of your own bank. Time was when I regarded such analysis as the most uninteresting occupation imaginable. This is so no longer. By degrees I have come to regard it as

engrossing, and you will share this view, for behind the bare, dry figures of (for instance) the last twelve years, one is able to trace the varying influences of gradual changes in mercantile custom, prosperity and adversity, quiescence and disturbance, war and peace.

Take one example only. Consider the significance of the variations in the amount of a bank's acceptances during that period. In some cases these variations have been extraordinarily significant of the changes in commercial and social conditions. Exercise your imagination with regard to them. Amongst other influences, they point to—

(*a*) The gradual entry of joint-stock banks into a domain once regarded as the exclusive territory of the accepting house and the merchant-banker. When I first entered a bank some forty-four years ago, one practically never saw the acceptances of an English joint-stock bank. Now one sees them to the extent of many millions of pounds.

(*b*) The diminution, owing to the submarine danger and warlike operations on the high seas during the War, of the international transactions, which gave rise to banking acceptances.

(*c*) The rise in the prices of commodities, and all that this has meant to you and me, and others like us.

Or, analyse and scrutinize the fluctuations in the amount and proportion of advances, before, during, and since the War, or even from month to month now. A study of these changes, and of the changes in the amount and proportion of other items, when once their causes and significance are grasped, will convert the dry bones of a bank's balance sheet into living history.

CHAPTER II

LENDING TO THE MONEY MARKET

"Money at call and short notice"—Uniqueness of the Money Market—London still pre-eminent—America and our market—Three main factors of the market: Lenders, borrowers and intermediaries—Lenders: the Bank of England; the private and joint-stock banks—Intermediaries: The bill brokers and discount houses; their functions; "the standing of parties"—How the banks lend to the bill brokers; the bank manager's "finance book"; "floaters"; the real Money Market—The banker's balance at the Bank of England—A Scotch banker's testimony—Advantages of Money Market transactions to the banker—And to the bill broker—When the market is "in the bank"; large issues by the Bank of England; the collection of taxes—Various classes of Money Market loans; "fixtures," day-to-day loans, overnight loans, "privilege money"—The bill broker's profit—Other elements in the market—The money broker—The issuing and accepting houses—The London branches of foreign banks—The British Government—Some foreign Governments—The Indian Government—A suggested chart of the market.

We are now going to deal much more in detail than in the last chapter with that part of the banker's lending function which has to do with the Money Market; to consider that part of his advances which, in his balance sheet, appears under the heading "Money at call and short notice."

THE MONEY MARKET

There are two curious facts which have often been noted in this connexion; the first is that, unlike the Stock Exchange, the Coal Exchange, the Metal Exchange, etc., the Money Market is not a market in the sense of being a single rendezvous or meeting place; it has no building in which it meets to carry on its transactions.

You will, however, be aware that a market does not depend, necessarily, on having a building, and that it

consists of men in close touch with one another as buyers and sellers. A market is not a place, but a body of people, interested from two standpoints—as buyers and sellers—in a particular commodity. Often it consists of quite a small number of people. It has been said that " two men, separated by the Atlantic, but connected by a cable, may constitute a market." This, like most epigrams, is not strictly accurate. There should be at least two men at the end of the cable, if the necessary element of competition is to be represented.

The second curious fact about the Money Market, which has also been frequently noted, is that it is less a market for money than for short credit. In most Money Market transactions no money passes. It is credit, short credit, which is dealt in and transferred.

So the description " Money Market " is, in a sense, a misnomer. It reminds one of the famous remark about the Holy Roman Empire: " It was not holy, it was not Roman, and it was not an Empire, but otherwise the title is perfectly accurate."

Nevertheless, the term " Money Market " is a convenient name for the daily traffic in the Short Loan Fund. How that fund is constituted, we shall see a little later.

THE LONDON MONEY MARKET STILL PRE-EMINENT

Notwithstanding the effects of the War, the London Money Market, owing largely to our highly developed banking system, is still the most important of the world.

This fact, and the further fact that London was, before the War (as it has again become), a free market

for gold, was the reason why most of the world's needy borrowers used to come to us for capital. Colonial Governments, foreign railways, needy foreign municipalities, impecunious foreign States, all looked to London to supply their needs, and rarely looked in vain. All could get accommodation "at a price." Financially, as Bagehot put it, London was "the milch-cow of the Empire and the world."

The War has shaken the position of London in this respect to some extent. The Money Market of the United States is growing. Undertakings in various parts of the world, once financed by us, have been financed by New York. Our own Government, the Governments of our chief Allies and of our Colonies, have borrowed there. Even English municipalities have made inquiries as to the possibility of floating loans in the States.

Notwithstanding this, the bill on London is still in request throughout the commercial world. London remains the world's financial centre.

This is partly due, as you know, to the high standing and world-wide reputation of the London accepting houses and banks.

America and our Money Market. Mr. Otto Kahn, after a visit here from the United States, frankly admits that the pre-eminence of London has survived the War, and gives other reasons. "The often-heard talk of our displacing England as a world's financial centre is idle. . . . The traditional position of England is the result of geographical, economic and psychological factors, of racial qualities, and the experience and practice of centuries. . . . It is impossible to fulfil the functions of a great financial world centre without having a broad market of genuine receptivity for many kinds of foreign investments.

We, in America, have no such demand as yet. . . . Another requisite for a great financial world centre is a healthy, active and regular discount market, which, thus far, we have not developed to the necessary degree." Commander Hilton Young, whose right to speak with authority in financial matters is generally acknowledged, has told us that New York is not yet so experienced a lender as London is; that it does not know the borrowers of the world or understand their needs so well as London does.

THREE MAIN FACTORS OF THE MONEY MARKET

Theoretically, the Money Market consists of three groups, lenders, borrowers and intermediaries, but they shade off, they overlap, to such an extent, that it is impossible, beyond a certain point, to take them class by class and consider them under these headings. I shall, therefore, take the constituent elements of the market as they come, and shall not attempt to keep up this classification throughout, though I shall adopt it as far as possible, as a matter of convenience. Theoretically, it is excellent; in practice, it is unworkable.

Let us consider first, then, the lenders to the Money Market.

Lenders to the Money Market.

1. The Bank of England. First, we have the Bank of England, the centre, geographically and otherwise, of the market. It is "ringed round" on all sides by other great financial institutions.

The Bank of England is a borrower, of course, as regards its depositors, like all other banks, and during the War, as we have already noted, it was a borrower from the other banks. It took from them part of

their "short money" at three days' notice, and allowed them interest on it.

But, mainly, and in normal times, the Bank of England is a lender, an occasional lender, to the market.

I do not propose to give a disquisition on the functions of the Bank of England; how it keeps the balances of the British Government, manages the Government issues of stocks, and acts as registrar of such stocks, and how it has certain privileges with regard to the issue of bank notes. These are side issues for our present purpose. Besides, you know all about them. All that concerns us here with regard to the Bank of England is that it is the centre of the Money Market by reason if its being the bankers' bank. In London, and wherever the Bank of England has branches, the other banks keep their spare funds with the bank, and, as a consequence, it is the holder of the ultimate gold reserve of the country.

But the Bank of England is only an occasional lender to the Money Market, as we shall see presently. For reasons which we shall go into, it is not applied to for short credit if such credit can possibly be obtained elsewhere.

Another group of lenders consists of the private and joint-stock banks.

2. THE PRIVATE AND JOINT-STOCK BANKS. I have mentioned the private banks first, from the courtesy always due to age, but, for good or ill, such banks have almost died out. Personally for various reasons I regret this, but we have to face the fact that the private banks are no longer a factor to be seriously reckoned with from our present standpoint.

The joint-stock banks are a very important source of supply to the Money Market. Some of them have

deposits from the public which are much larger than those of the Bank of England—

	(September, 1925.)
Midland	£347,733,000
Lloyds	334,615,000
Westminster	258,836,000
Barclays	295,070,000
National Provincial	245,848,000
Total	£1,482,102,000

It is a proportion of these deposits which constitutes a considerable proportion of the "Short Loan Fund"; that part, in point of fact, which, as already noted, appears in the balance sheets of the respective banks under the heading "Money at Call and Short Notice."

At the end of 1918 the "Big Five" banks alone had no less than 160 millions so lent, but the item was unduly swollen at that time owing to the inclusion in the total of the "three days' money" lent to the Bank of England.

At the end of 1919 those five banks alone had 96 millions lent out to the Money Market proper, and in June, 1920, twenty banks of the United Kingdom had 115 millions so lent. Add to the amount thus lent to the market sums lent to it by other institutions to which reference will be made a little later, and you will gain some idea of the magnitude of the "Short Loan Fund."

And now, having mentioned some of the lenders, and leaving others over until a later stage, we come to a much more interesting element in the market.

The Bill Brokers and Discount Houses. These are borrowers from the joint-stock and other banks, from

other sources, and, occasionally, from the Bank of England. They are lenders, in the sense that they discount bills for banks and commercial houses which have bills for discount, and they are also, and mainly, intermediaries between bankers on the one hand and, on the other, parties who have bills to discount—business houses, British and foreign; banks in foreign countries and in our colonies and dependencies, and various other institutions.

Incidentally, the fact that bill brokers are borrowers, lenders, and intermediaries, illustrates what I stated a little earlier with regard to the difficulty of classifying strictly the elements of the Money Market.

The three principal houses in the Discount Market are the Union Discount Company of London, the National Discount Company, and Alexander's Discount Company, but there are many others, some of them limited companies and some firms of the highest repute.

The functions of the bill broker have been variously defined. He has been described as "the bankers' jackal," the banker being the lion and the bill broker the creature which provides him with food. He has been called "the parasite of a parasite," the second parasite being the banker.

All sorts of friendly libels are always afloat about bill brokers. I remember, many years ago, agreeing to look after the *Economist* for a few weeks, the then editor having had a paralytic stroke. The deputy chairman of the bank in which I was employed was an old Money Market man, and was good enough to take me under his wing and introduce me to the discount houses, so that I might be in touch with the market, and his jocular form of introduction at the first discount house at which we called was "This is

Mr. A., the manager, and these are Messrs. B. & C., his assistants. Now, in the discount market there are two classes of liar—the one-sixteenth liar, and the one thirty-second, and I leave you to find out to which category these three gentlemen belong."

The point naturally arises, Why is a bill broker wanted at all ? What need is there of an intermediary ? There are no bill brokers in the Continental Money Markets, just as there are no jobbers on the Continental Stock Exchanges. Why do not the holders of bills who wish to discount them go always, as they do sometimes, direct to the banker ? The reason is that the bill broker is one of the many examples of specialization in financial matters in this country. The banker has a hundred functions ; he keeps current and deposit accounts, takes charge of valuables, makes advances and discounts bills, holds bonds and collects the relative coupons, pays club and hospital subscriptions, receives dividends direct for customers, etc. Sometimes, it is alleged—not truthfully, I sincerely hope, that he sends a van round to collect credits, and a taxi with the money for wages. Moreover, the functions of banks are continually extending. Some of our American men friends in the West End expect a reading and smoking room to be provided for them as a haven of refuge from their wives, while their womenfolk expect a bank to be a parcels office to which they may consign their purchases, and also expect the bank to provide a " petticoat room " in which they may rummage in the pockets of mysterious under-garments for their letters of credit or circular notes.

Now, while the banker exercises all the functions enumerated, and many others, the bill broker specializes in one department, namely, obtaining and discounting bills of exchange.

For obtaining them he has special facilities. He has connexions of various sorts and degrees. Some of the smaller fry have "runners" who "tout" for bills. Bankers do not go so far as that yet in this country; nor, of course, do the big discount houses.

Further, the bill broker is believed to offer his clients accommodation on slightly better terms, and we all know what trouble some people will take if they think they can get something more cheaply in one quarter than in another.

> Oh! cheapness is a pleasant thing,
> Beloved from pole to pole.
> To get a thing for one-and-four,
> For which a friend paid two-pence more,
> Is joy unto the soul.

Mr. Spring Rice, an authority on bills, propounded another theory on this point to the Liverpool Institute of Bankers not long ago. He told his audience that the discount market obtains bills, not so much because it quotes lower rates or because it has agents and other indirect means of securing them, but because the sellers know that it is a real market, in which a quotation of some sort is always obtainable, and which therefore earns the offer of part at least of any such business there may be.

With regard to the discount of bills, the bill broker has special skill and special knowledge as to the "standing of parties." He can tell you, without reference, the financial position of big houses all over the world, and, by ready reference, the standing of practically everyone engaged in commerce.

It is true that every bank has an "Information Department." Every bank represented here has an elaborate system of card-indexes, with information as to various firms and companies, and employs a special staff to keep the information constantly up to date.

But bill brokers specialize more completely in this one department. They are wonderful storehouses of information, and up-to-date information, about every firm and company in every trade. They have "suckers" and "feeders" in every centre, and these keep them informed as to every fleeting change in the credit of local concerns, not in this country only, but the world over. As a waiter's memory is for orders, so is a bill broker's for the standing of parties, and, just as Thackeray tells us, in *Vanity Fair*, that Captain Crawley "made an effort, as became a Guardsman, to recollect the number of Captain Osborne's regiment," so the bill broker, tackled with the name of a firm, will recall information as to its financial position, and (but this is another friendly libel on the bill broker) it is alleged sometimes that, if he cannot remember it, he will evolve it from his inner consciousness.

Now from what sources does the bill broker get the funds with which he discounts commercial paper and buys bills from foreign and colonial banks to such a great extent? The total of bills discounted by the three leading discount houses alone, as given in the *Bankers' Almanac* at the time of writing, is well over 96 millions sterling.

Well, first of all, the bill broker has, of course, a certain amount of capital, although (another libel) it used to be said that a bill broker's capital consisted of a pair of boots and a bill case. But the total of his investments, in practically every instance, exceeds the amount of his paid-up capital, so we can ignore this item for the present purpose.

Then he gets deposits from the public, including some country banks. For these, as you will see in the money article in the newspapers, he offers slightly

higher rates than bankers. When bankers are advertising 3 per cent as their rate for deposits at seven days' notice, the discount houses advertise 3 per cent as the rate they are willing to give for money at call, and $3\frac{1}{4}$ per cent as their rate for money at notice.

Then, too, the bill brokers get the loan of short funds from bankers, from issuing houses, from foreign banks, from big companies—from railway companies, for instance, during the period immediately preceding the dates on which their dividends are paid—and from other sources. In the last resort, they obtain the necessary funds from the Bank of England. Let us examine these sources, one by one.

We will take, first, the short money from the banks, the "Money at Call and Short Notice" which figures on the banks' balance sheets.

How the Banks Lend to the Bill Brokers. May I give you a personal experience, to illustrate how the banks lend and the brokers borrow?

Over 40 years ago, my morning's work was to write up pass books and give them out to customers at the head office of the London & County Bank, and for this purpose I sat at the counter, at the pass book desk. Every morning, between ten and eleven o'clock, I used to notice a dozen or more well-dressed and well-groomed men passing along the public space in front of the counter in the direction of the manager's waiting-room. When they arrived at the waiting-room, they used to chat with each other and chaff, and I used to be considerably puzzled as to what business they were there to transact, so on one occasion I put the question to the cashier who sat next me. The answer was, "Oh, don't you know? They are the bill brokers." I am sorry to have to confess that this reply conveyed

no meaning to me in those days. What I did know was that I wished that my lot had been cast in an equally pleasant place. Later on I learned that these men were among the *élite* of the financial world, and that they included among them some of the keenest minds in the City, some of them being high authorities on financial matters.

Well, the bill brokers still come into the big banks, and into other institutions, every morning, as described, and, as I have told you what takes place on one side of the partition between the City manager's room and the waiting-room, with its group of waiting brokers, let me tell you what happens on the other side, the City manager's side of the waiting-room door.

THE BANK MANAGER'S "FINANCE BOOK." In the manager's room sits the City Manager, or "Treasurer," as he is called in some banks, and before him lies the "Finance Book," containing a forecast of the bank's financial position and requirements for the day.

On one side of this book are entered the following items—

The overnight balance at the Bank of England.

Particulars and total of funds expected to come in that day.

Total of the proceeds of the bills and cheques which are being collected that morning.

Total of bills discounted maturing that day.

Particulars and total of Money Market money which matures that day.

Total of special deposits advised from branches, or elsewhere. In short, on this side of the book are entered all the items which will increase, during the day, the balance at the manager's disposal. Most of these items are already entered when the manager first opens the book. There is no need for a highly skilled

and highly paid official to trouble about details which his subordinates can attend to equally well.

On the other side of the Finance Book are the following items—

The amount which the manager wishes to have to the credit of his bank at the Bank of England that evening.

The total of large deposits payable by the bank on that day.

The total, from the bill diary and from a summary of the advices, of bills payable at or by the bank.

Details and total of special remittances of large sums to branches.

Estimated total of dividends payable by the bank on that day.

Total of big payments generally, to be made for self and branches.

And another item: "Contingencies," which is of some importance.

Framing an estimate of this last item gives a fair amount of scope for the manager's experience and skill. Many of the other items are matters of fact and of routine. Not so "Contingencies," which are as elusive in banking finance as many of us used to find the item "Sundries" in the days when we used to keep a strict account of our personal expenditure.

These items (like the items on the other side) are duly summed up. If the total of the "incoming" items exceeds the total of the items on the other side —the amount to be paid out during the day—the balance is the surplus which may be safely and profitably lent to the waiting brokers. If, on the other hand, the balance is the other way, if the amount to be paid out exceeds the amount receivable for the day, the difference constitutes the amount which the banker

may call in from the brokers, in order to enable him to maintain his balance at the Bank of England.

As a rule, in that case, he calls in only part of the money he has previously lent.

Of course, different banks "run their Finance Books" in different ways, but the foregoing will serve to give a general idea of the usual way. There is little difference in principle, although the practice varies considerably.

You will notice that one of the objects which the manager keeps steadily before him all the time is to make sure of having a certain amount to the credit of his bank at the Bank of England at the end of the day. This gives an additional interest to his work. It is as engrossing as guessing, in connexion with a ship sweepstake, the length of the day's run.

In either case, the balance having been struck, the waiting brokers enter one by one. Assuming that the bank has a lendable surplus, the City manager or treasurer arranges with each broker how much he may have, what the period of the loan shall be, and the rate of interest to be paid.

If, on the other hand, the bank should be "short," the process is reversed. The manager than says he will require, a little later in the day, some portion of the funds previously lent to the broker.

In either case, the manager makes a note of the arrangement, and passes it out to the Securities Department, and later in the day, if the bank is a "lender," bills or "floaters" are deposited with the bank as security for the advance, and the agreed amount is credited to the broker's account, or handed to him in the form of a cheque. If any of the bills mature during the currency of the loan, the broker replaces them by other bills of a similar class.

If, on the other hand, the bank is "calling in," the broker sends round his cheque, in reduction or repayment of the loan, and gets back in exchange a parcel of bills or the "floaters" which formed the security.

"Floaters," it may be remarked, are "gilt-edged" Stock Exchange securities—short-dated National War Bonds, Exchequer Bonds, Treasury Bonds created during and since the War, etc. How the description "floaters" came to be adopted I do not know. I have an impression that they were so called because they "float" in and out of City managers' rooms in the manner I have described.

With regard to the proportion which bills and Stock Exchange securities respectively bear as security for bankers' loans to the Money Market, Mr. Spring Rice, speaking at Liverpool in February, 1923, estimated that bills form about 90 per cent of the total security which the market deposits with the banks.

The process above referred to, carried out during the early part of the day in a number of City managers' rooms, is the real Money Market.

The market consists largely of bank managers and bill brokers meeting to lend and borrow respectively for short periods; men who sit in bank "parlours," lending out short credit at the highest rates obtainable, and men who call on those managers to obtain such credit at the lowest rates possible.

The Banker's Balance at the Bank of England. I may mention, in passing, that the "evenness" of a bank's daily balance at the Bank of England is another of the tests of the City manager as a financier. If, as a result of the day's transactions, there is too large a Bank of England balance in the evening, this means a loss of interest. The excess might have been lent out to the Money Market at a remunerative rate. If,

at the end of the day, there is too small a balance at the Bank of England, this constitutes a departure from the understanding by virtue of which a balance of a certain amount shall be maintained.

A statement of the daily balances at the Bank of England is produced and scrutinized daily at each bank by a committee of directors, and a similar statement is read out weekly at the meeting of the board, and explanations are asked for if there has been very much variation in the usual amount. These explanations vary. "The ——— company or bank drew heavily at the last moment." "The ——— branch omitted to advise a large withdrawal (or deposit)," etc.

Incidentally, these daily visits of the brokers are useful in other ways. Not only is the banker able, by means of them, to gauge the "tone of the market," but the brokers often impart valuable information of a financial character, rumours of impending trouble, etc. The whole business is interesting to all the parties concerned.

A Scotch Banker's Testimony. Here is the testimony, as to this, of Mr. G. J. Scott, now Treasurer of the Bank of Scotland, who for some years, before returning to the North, dealt with the Money Market daily on behalf of the Union Bank of Scotland—

To those who have been fortunate enough to spend some years in the City, it will always seem that the experience was the most fascinating in their career. No other sphere has the same perennial and absorbing interest. Under what may at times to the casual observer bear a conventional and calm exterior, you may have forces strained almost to breaking-point, when you seem to feel the pulse of the universe beating rapidly with the pent-up emotion of, it may be, a political contest, or an industrial climax.

In no other place is the financial machine so sensitive: a breath of discredit on a well-known House, a lurid speech of an oratorical M.P., or an unexpected issue to help Government finance, and at once the aspect of the market changes, whilst gossip, more or less imaginative and highly-coloured, runs riot. Figuratively, the bank

manager sits with the wireless at his ear, and when there is a momentary shiver in Wall Street, or Paris becomes unusually excited over a speculative deal that miscarries, the message goes straight and swift to its destination.

It is the business of the broker, in addition to his regular daily visits, to ascertain, from the advertisements of prospectuses of new issues in the newspapers and from other sources, which financial houses are likely to have short money to lend. The money so obtained is employed in discounting bills, and the bills so discounted are either lodged with the banks as security for advances, in the manner fully described a little earlier in these remarks, or re-discounted with the banks at a small profit.

Advantages to the Banker. The advantage of these Money Market transactions to the banker is threefold—

1. He gets exactly the kind and currency of bills he wants.

He may, for example, stipulate for "all sixties"—bills all payable sixty days on. This helps him in his financing generally. Towards the end of October, for instance, a parcel of sixty-day bills discounted will mature just before the end of December, and increase the banker's cash balance at the end of the year.

2. He gets big parcels of bills.
3. He gets the broker's guarantee.

A bill broker gives a banker a guarantee, under which the broker pays, "on the nail," for any of the bills he has put in which may be dishonoured. This guarantee is treated as a substitute for an endorsement on the bills themselves.

Advantage to the Bill Broker. The advantage to the bill broker of these banker's advances is that, by them, he gets the funds with which to discount more

bills at the fractional profit which provides him with a living.

When the Market is "in the Bank." There are times when bankers cannot lend to brokers; when, for example, the Bank of England makes a large loan issue on behalf of the Government. In that case, other bank's balances are depleted to the extent to which their customers draw cheques with which to apply for the new loan. Consequently, at such times, banks either call in money from the Money Market, or are not in a position to lend further sums. In such cases the brokers have to apply to the Bank of England for accommodation.

Another cause of the inability of bankers to lend at times to the Money Market is the collection of taxes, especially during the last three months of the Government financial year—the first three months of the ordinary year; and, latterly, since certain Government taxes have been payable in two instalments (the second on the 1st July), in July and August. At these times tax-payers draw on their bankers, and the cheques are paid into the credit of the Government at the Bank of England. Government deposits, as the Bank of England weekly return shows, increase in consequence, whilst "other deposits" decrease.

During the periods indicated bankers, as a rule, have less to lend to the market than in normal times owing to these tax collections, but they are able to keep themselves in funds at such times by letting some part of their holding of Treasury bills mature.

When bill brokers cannot get the accommodation they require from the banks, and have to go to the Bank of England for it, the market is said to be "in the Bank."

VARIOUS CLASSES OF MONEY MARKET LOANS

Four kinds of loan are made by banks to brokers.

1. Loans for a short period ; say, a week.

These are called " fixtures." You will notice from the newspapers that the rate charged by bankers and others for " fixtures " is practically always less than the rate of discount at which Treasury bills are allotted. Incidentally, this enables the bill brokers to take up and hold Treasury bills at a profit.

2. Day-to-day loans.

The rate of interest charged on these is usually lower than the rate on " fixtures."

3. Over-night loans.

The rate for these is usually lower still, but it is higher when the market is " short."

4. " Privilege Money."

Let us consider each of these classes of loan a little more closely.

1. Fixtures. These are funds lent for a week, or thereabouts ; in the case of the " Big Five " banks, the period of ten days is rarely exceeded. Other institutions—some foreign banks, for instance—may, and do, by special arrangement, lend to the market for longer periods. It is believed that most of the money lent to the market by the joint-stock banks is in the form of " fixtures," one reason for this being that they could not get the market to take such large sums if the loans could be called in at a day's notice.

2. Day-to-Day Loans. If these are not called in before noon, they are at the disposal of the broker for another day. They are a temporary expedient, pending the finding of a permanent home for bills which the brokers have discounted. Such loans are

sometimes allowed to run on when "Weekly Loans" are called in.

3. **Over-night Loans.** These are repaid "automatically" the next morning. They come, in the language of the Money Market, under the category "Bad Money"; money which the broker knows will not be left in his hands long, as distinguished from the bulk of joint-stock bank money with the market, which is known by the bill brokers as "good" money.

The bill broker has bills brought round to him by a client for discount just before closing time. Rather than refuse them, he dashes round to, or rings up, banks and other institutions which sometimes have surplus funds at the end of the day.

Also, just as the banker, early in the day, "makes up his book," so the broker, besides making up an early morning book or estimate, makes another, in a sense, after he has ascertained, in the course of his morning round in the City, how he stands as regards funds. If he is "short," he may try for "night money" to tide him over. He dashes round to the Scotch and foreign banks, or other financial houses, in the hope of being able to effect a very temporary loan.

4. **Privilege Money.** Privilege money is defined by Mr. Spring Rice as money which the principal discount houses have the right to draw on certain banks with which they keep accounts. It enables them to take a parcel of bills from a foreign or other customer just before closing time, when it would otherwise be physically impossible for them to obtain, in time, the money wherewith to balance their books. Privilege money is not being increased by the banks.

I may say that some of the Scotch banks have slightly different arrangements as to the duration of

short loans to the Money Market, but there is no need here to go into this.

When driven to the Bank of England, brokers have to pay more for the accommodation granted to them than is charged by the joint-stock banks. The charge is generally one-half over Bank Rate.

At the Bank of England, moreover, there is no "day-to-day" lending and no "over-night" lending. Advances by the Bank to the Money Market are made, as a rule, for periods of a week; sometimes for a few days longer. It is a matter of arrangement. Further, the Bank will not allow more than a certain total of loans to the market as a whole to mature on any given day, and will not allow any one borrower to have more than an amount which it considers reasonable for that borrower to repay on one day. Moreover, the Bank of England is somewhat more exacting in the matter of "margin" than are the other banks.

For all these reasons, bill brokers never apply to the Bank of England for accommodation if they can possibly obtain it elsewhere.

THE BILL BROKER'S PROFIT

1. At times brokers re-discount with the banks the bills that they have discounted for their own customers, and the fractional difference in rate constitutes their profit on such transactions, but it should be noted that the banks are not always ready takers of such bills.

2. At other times the brokers, having discounted bills for their customers at market rates, borrow money on the bills from bankers at a lower rate, in the manner indicated a little earlier in these remarks, and let the bills mature. In this case their profit consists of the difference between the rate at which they have discounted for their clients and the rate at which they are

able to borrow the money with which to carry the bills. The bulk of a bill broker's profit is derived from this source.

During the War international commercial bills almost disappeared, and the bill brokers had, perforce, to limit their operations mainly to the discount of Treasury bills and what they describe as "white paper," i.e. inland drawn bills. Also, discount rates were governed, not by Bank Rate, as they were to a certain extent before the War, but by the rate at which the Government issued Treasury bills.

No apology is needed for the time I have given to considering the functions and the operations of the bill brokers, as they are by far the most important of the "intermediary" elements in the Money Market.

THE MONEY BROKER

Another element in the Money Market is the "money broker."

A money broker is a member of the Stock Exchange who, in addition to buying and selling stocks and shares for his customers as other stockbrokers do, acts as an intermediary between the banks on the one hand, and smaller Stock Exchange firms on the other. He borrows from the banks against high-class securities at comparative low rates, and lends the money so obtained to the smaller fry of the Stock Exchange against lower class securities at higher rates.

Just as the bill broker is an intermediary between the banks and commercial discounters, so the money broker is an intermediary between banks and smaller stock exchange firms. He borrows from the banks in order to lend, at higher rates, to the "small fry" of the Stock Exchange. His *raison d'être* is that the banks would, very properly, decline to lend direct,

either to stockbrokers or to anyone else, against the more highly speculative shares which are largely dealt in on the Stock Exchange.

I will now touch lightly on other elements in the Money Market.

THE ISSUING AND ACCEPTING HOUSES

Some of these issue, but do not accept; others accept, but do little in the way of new issues, but many of them perform both functions. Issuing houses are largely a lending factor in the market. They receive applications from the public for loans to States, corporations, companies, etc., and the bill brokers, as already indicated, ascertain from the newspapers and from other sources which institutions are likely to have application moneys on their hands for a short time, and call on such houses in the hope of being allowed to borrow some portion of such moneys. In this sense, the issuing houses are lenders to the market.

The acceptances of the accepting houses, in normal times, constitute a fair proportion of the bills in the portfolios of the bill brokers. The bills which the accepting houses have accepted are offered for discount in the market. In exercising their function as accepting houses, they are neither borrowers nor lenders to the market. They simply supply others with the "raw material" for borrowing by way of discount. The mere fact that the acceptance of a first-class house appears on a bill enables the holder of the bill to "melt" it at a very favourable rate.

The leading houses of this kind for the most part exercise the two functions.

1. By arrangement, they give their acceptance to bills of exchange, thereby rendering the bills discountable at the finest rates, as explained above.

2. If required, and if conditions be propitious, they issue foreign and other loans.

The tacit understanding that certain issuing houses shall be allowed the exclusive right to bring out new issues for a particular country is not quite so rigidly observed as it once was. Competition in such matters, as in so many others in the financial world, gets keener day by day. Nevertheless, as between themselves, this understanding is still fairly well observed so far as the leading merchant bankers are concerned. Such breaches of it as occasionally occur are generally the result of the action of either the would-be borrowers themselves or of "outside" houses which are anxious to get into the inner ring of issuers, and which, for that reason, offer specially favourable terms.

Another element in the Money Market consists of the London branches of foreign banks.

THE LONDON BRANCHES OF FOREIGN BANKS

Although these are sometimes sellers of bills to the market, and thus, in a sense, borrowers, they are largely a lending factor. They lend their surplus funds here, sometimes to bill brokers direct, in the form of short loans, as the English joint-stock banks do. Sometimes, too, they lend to the British Government, by tendering for Treasury bills.

A further and very important factor in the Money Market is the British Government.

THE BRITISH GOVERNMENT

As you are well aware, the Government obtains temporary accommodation by the issue of Treasury bills. It did this, of course to a very much smaller extent, even in the time before the War. It has done

so to an enormous extent during and since the War. To the extent to which these bills are purchased by the market, or with funds which would otherwise reach the market, market funds, actual and potential, are diminished ; the market is, in a sense, a lender.

On the other hand, the maturing of these bills has the opposite effect ; it adds to the market's resources.

These Treasury bills constitute the bulk of the " floating " debt, as distinct from the " funded " debt of the country.

Amongst other forms of floating debt are what are known as " Ways and Means Advances." These are temporary borrowings by the Treasury from the Bank of England and from certain public departments. When, for example, the Treasury has twice a year to provide for the payment of the interest on the huge amount of the 5 per cent War Loan, part of the necessary funds is obtained by means of a temporary advance from the sources indicated.

There is reason to suppose that " advances from public departments " take the place of the old Treasury Chest fund, and that when the amount of this item falls below a certain figure the deficit is being used in the re-purchase of Treasury bills or the purchase of short-dated dollar securities in anticipation of the two significant dates—15th June and 15th December.

A further element in the market consists of certain foreign Governments.

CERTAIN FOREIGN GOVERNMENTS

A foreign Government raises a loan here. The proceeds of the loan are not immediately remitted to the foreign country. It would be useless and wasteful to remit it and then bring it over here again, since a fair proportion of the money may be required,

sooner or later, on this side, possibly for payment for warships built in our yards, for the interest on previous loans, for the purchase of material for railways, etc.

Some of this money may be invested in Treasury bills and some of it may be placed out at interest, with banks and other financial institutions, at special rates.

From time to time very large sums are thus left in London, and some of the money finds its way, in the directions indicated, into the Money Market.

THE INDIAN GOVERNMENT

The Government of India used to play a double rôle in the London Money Market. It was sometimes a lender ; sometimes a borrower. Now it is, normally, only a borrower, an absorber of market funds. It collects its revenue in India in silver, in rupees, but it has to pay large amounts in London in gold, for the interest on its loans and other purposes, and it contrives to do this by getting the India Council in London to draw, on the Indian Government in India, " India Council drafts," as they are called—drafts payable in silver at Calcutta, Bombay or Madras—and to sell these drafts in London to any parties who, like the Indian banks in London, have occasion to make remittances in silver to India. As these drafts are paid for by the purchasers in British currency, the Indian Government thus obtains the gold it requires in London, while the Indian banks and others who have occasion to make remittances to India in silver are, by the same operation, furnished with the means of doing so.

The India Council used to lend its floating balances to the London Money Market for periods of from two

to four weeks, against security, generally in sums of not less than £50,000. One used frequently to see in the papers, "The India Council lent a fair amount at ——," but this one sees no longer.

A RÉSUMÉ

To test the clearness of your impressions of what has been said in this lecture of the structure and working of the Money Market and of the relations of the market with the banks and other financial institutions, I suggest that you draw a rough map or plan, something on the lines of an astronomical chart.

In the centre of this chart—where the sun would be if it were astronomical—draw a circle representing the Bank of England. Clustered round it, draw other circles or figures representing the joint-stock banks. Then draw an outer ring of circles representing the discount houses, and outside this ring again, draw other geometrical figures representing the other factors in the market which I have indicated, the Money Broker, the Stock Exchange, the issuing houses, etc.

Then, by means of arrows or any other suitable device, indicate how each group "feeds" the market or is "fed" by it. The result will clarify your ideas, and will show whether I have succeeded to any extent in this attempt to show, in broad outline only, the structure and working of this curious and unique organization.

CHAPTER III

LENDING GENERALLY

THREE great points in lending; and a further point—Liquidness; bank advances contrasted with insurance companies' and building societies' finance; the Australian bank crisis of 1895—Some definitions—Discounting: some pitfalls—The growing scarcity of trade bills—Various classes of loan—Loans to the Stock Exchange—Loans to other borrowers against Stock Exchange securities—How stocks and shares are hypothecated: "bearers," registered stocks, inscribed stocks—Margin—Curious misconceptions—Advances against produce: their advantages and risks—Advances against life policies—Advances against guarantees—Advances against deeds of property; examination and valuation; hypothecation—"Border-line" securities—Second mortgages—Mortgages on ships—Charges on uncalled capital—Reversionary interests—Assignments of retention moneys—Unquoted shares—Mill, factory and mining properties—Brickfields—Buildings in course of erection—Shares involving a liability—Curious securities offered—Unsecured advances—Examination of a trader's balance sheet—A company's balance sheet; the "real" surplus—Balance sheets generally—Preliminaries to advances to farmers and to traders—Borrowers' assets, liquid and otherwise—The personal element.

SOME POINTS FOR LENDERS

THERE are three great points to be kept in view in this matter of banker's advances, and one minor one. The chief points are—

1. Safety (as with all lending).

2. The maintenance of a due proportion between the amount of the advances and the amount of the bank's liabilities.

3. That the advances be liquid; that they be of such a nature that they can be recalled without undue difficulty, and within a reasonable time.

4. That the advances be profitable; that a reasonable rate of interest be charged; that, if the advance take the form of a loan, as distinct from an overdraft, an adequate current account balance be maintained,

and that if it take the form of an overdraft, a reasonable rate of commission be charged on the turnover and that the turnover itself be adequate.

The first of these points is so obvious that there is no need to enlarge on it. The second has been dealt with in the first of these lectures. The third—the necessity for keeping advances fully liquid—calls for further comment. The safety of a bank's advances is not enough. The maintenance of a due proportion between the amount of its advances and the amount of its deposits is not enough. A further point of very great importance is that there must be no "lock up" of its resources; they must be so lent that they can be easily recalled. In this respect, banking finance differs from insurance finance. The money which an insurance office has to invest is not repayable on demand or at short notice. Consequently, both in its investments and in its lending, the insurance office has wider outlets, greater scope, for the disposal of its surplus funds. The balance sheet of any insurance company will show this clearly enough. It contains some items, such, for example, as "mortgages out of the United Kingdom," for which one would look in vain in the balance sheet of a bank. As with investments, so with advances. Insurance companies advance on the security of reversions, for instance, but inasmuch as reversions may not fall in for a very long period, not, indeed, until the death of the life-renter, they are not a suitable form of banking security.

In this matter of liquidness, also, and for the same reasons, banking finance differs from building society finance. This should be obvious, but some of the worst crashes in banking have been entirely due to its having been, temporarily, forgotten. The Australian banking

crisis of 1895, the blackest period in the financial history of the Australian colonies, is a case in point. There was a boom in real estate. Certain of the Australian banks lent, to an undue extent, against property, to enable their customers to take a hand in the boom. The boom broke. The prices of property collapsed, far more rapidly than they had risen. Margins of security disappeared, and were replaced by deficits. Property became practically unsaleable for a time, at any price. A run on the banks followed, and inasmuch as, in a number of instances, their resources were "locked up," bank after bank was in difficulties, and had to reconstruct. All this affords a lesson in the necessity of keeping a bank's advances liquid, and the curious thing about it is that the lesson has to be learnt, by bitter experience and in various countries, again and again by succeeding generations.

The best definitions of a banker illustrate and recognize this root principle. Some, I admit, do not. Sir Arthur Pinero, in one of his plays, defines a banker as "a pawnbroker with imagination." This is distinctly derogatory. The definition of an old collegaue of my own is "a bank manager is a cross between a country gentleman without his means, and an insurance agent without the opportunity of tracking his quarry to its lair." I prefer, in this particular connexion, the dictum of an earlier Lord Sydenham: "The art of banking consists in knowing the difference between a mortgage and a bill of exchange." This is the essence of the matter. A mortgage is a permanent form of lending; and not, therefore—speaking generally—a banking security. The discount of a bill of exchange is a temporary form, and is a most legitimate banking transaction.

DISCOUNTING

I shall begin, then, with a consideration of this ideal form of banking accommodation, the discounting of commercial bills of exchange; "ideal" because the accommodation is required and given for a short period; six months at the very outside; because the bill has, unlike a loan as a rule, a fixed date of payment; an element which helps the bank in its financing, and because the bill has more than one obligant. It must have an acceptor and a drawer, and it may, apart from the drawer, have one or more endorsers, so that, in the event of the failure of the acceptor and the drawer to provide for the payment of the bill at maturity, the banker can fall back on these.

It is here that, as I warned you at the commencement of these lectures, I shall have, for a very short time only, to tax the patience of many by being elementary, for I am going to state, briefly, the circumstances in which the ordinary inland bill of exchange originates.

We will assume—to take a typical case—that a builders' merchant has supplied a builder with fireplaces, baths, tiles, etc., to fit into the houses he is building. The builder has not a large capital, and cannot pay for these goods until the architect gives a certificate to the effect that an instalment of the building contract money is due; therefore he, the builder, accepts a bill of exchange, making himself liable to pay the amount in, say, three months. But the builders' merchant cannot wait for three months before paying the manufacturer for further goods which he himself has bought. He, therefore, brings the builder's bills to his banker to discount; to turn into cash.

Until this stage this has been a matter purely between the builders' merchant and the builder, and what has been said merely explains how the bills originated. The banking part of the transaction comes now.

We will assume that the banker knows that the financial position of his customer, the builders' merchant, who has brought the bills for discount, is fairly good. He has seen his balance sheet. He has a knowledge of his character and business ability, derived from a course of dealing extending over many years. It is just possible that if the customer's financial status is undoubted, the banker will discount the whole batch of bills forthwith; otherwise he discriminates. He discounts some of the bills; those of which the acceptors are known to be good; and hands back those of which he knows the acceptors to be impecunious. Others he holds over, pending the result of the usual status inquiries from the bankers of the acceptors, such inquiries being usually made as to the acceptors' sufficiency for a larger amount than that of the bill or bills actually offered for discount, since it is not to be presumed that these are the only bills which the acceptor has accepted. The probability is that he has given acceptances to merchants in other trades for goods they also have supplied.

There are pitfalls to avoid in this matter of discounting. A case in the criminal courts illustrates one of them, but that was a case of sheer fraud, by collusion between the manager and the customer. There is also the risk of discounting accommodation bills—"kites"; bills which do not represent actual commercial transactions, such as the purchase of goods, but which are merely a means, as between the acceptor and the drawer, of "raising the wind." If you are asked to discount a bill, J. & H. Pigiades on Porkiades

Brothers, you will be justified in having a shrewd suspicion that such a bill comes into the category described by bankers and bill brokers as "pig upon pork."

Then, there is the "one-legged" bill, the bill one of the parties to which only is good financially. There is a wholesome rule in banking, in this matter of discounting, that every bill discounted should bear at least two good names. In the simplest cases of discount transactions, the customer who offers the bills for discount is himself the drawer, and it will be clear that if the acceptor should be weak, the banker, if he discounts the bills, is practically making an unsecured advance to his customer.

But bills are getting scarcer, as the years go by. Compare, in this respect, the balance sheet of a bank, say, forty or fifty years ago, with that of a present-day bank, and you will probably be surprised at the much larger proportion of discounts to other advances in the older statement. Forty years ago, on the fourth of each month, when so many bills fall due, squads of men in banks had to be drafted from other departments into the department which paid bills of exchange under advice from branches and from banks of which the bank was agent, and twenty years before that the pressure in that department was greater still. Now, it is much less severe.

The reason why bills nowadays are comparatively scarce is that limited companies, with large cash resources, have to so great an extent replaced private traders. Instead of accepting bills, which the seller of the goods can discount, they pay cash, in order to get cash discounts from the seller.

Owing to this comparative scarcity of bills, the banker falls back increasingly on loans and overdrafts

for the employment of his resources, and we will now consider the various classes of loan.

VARIOUS CLASSES OF LOAN

We will discuss loans in the order of liquidness. May I say that what follows does not purport for a moment to be an exhaustive disquisition on banking securities. Far from it. Treatises on this subject are published in abundance. Reference will naturally be made to various classes of security, but it will be more in the nature of a rapid and general survey than a detailed examination.

Advances to Members of the Stock Exchange Against Stock Exchange Securities. These are made "from Account to Account," practically fortnightly. They are an admirable form of loan. The security is good and easily saleable, and an ample margin has to be maintained. They are also of short duration. It is understood that the banker need not renew them. He need give only a couple of days' notice before the fortnightly Stock Exchange settlement, and he gets his money back.

The *raison d'être* of this kind of loan may be that the broker's client has bought certain shares for a rise. The rise does not come off. The broker's client does not want, or is not able, to pay for the shares, so the broker pledges them, with other securities, with the bank, and pays the jobber for them with the money obtained from the banker.

Advances to Ordinary Customers Against Stock Exchange Securities. These are a little less liquid, because there is no understanding about their being repayable at the next Stock Exchange "Account." Still, they are liquid enough, and, if good judgment has been shown by the lender, they should be safe.

With regard to the banker's method of completing his security, if the securities be bearer bonds, or of a similar nature to bearer bonds, in that they pass freely from hand to hand, such as American railway certificates, a printed form of "letter of deposit" is taken, the borrower signing the letter over a 6d. stamp. This "letter of deposit" defines the conditions on which the advance is made, and includes, among other items, an undertaking on the part of the borrower to maintain a given margin during the currency of the loan and an authority to the banker to realize the security under certain specified conditions.

If the security be a registered stock, in the ordinary sense of the term, that is, a stock which is represented by a certificate which must be given up when the security is sold, the borrower signs, over a 6d. stamp, a "letter of deposit," as in the previous case, laying down the conditions on which the advance is made; and, in addition, executes a transfer of the stock into the name of the bank or its nominees. This transfer should be stamped with a 10s. stamp, that being the appropriate amount for a transfer on a nominal consideration. The transfer is sometimes registered, in which case, of course, the stock passes out of the name of the borrower. By some banks it is held unregistered in exceptional cases, but in such cases notice of lien is given by the bank to the company to whose shares it relates.

There are, unfortunately, all sorts of variations of the above procedure. It is said that some banks, even in the case of registered stocks and shares, take a letter of deposit only. Other banks are said to take a letter of deposit with a "blank" transfer only; that is, a transfer with the name of the transferee not filled in. It is much to be regretted that there should

be so many differences of procedure in different banks in this matter of the method of holding registered stocks and shares as security for advances. It gives rise to bickering and trouble which, by co-operation, might easily be avoided. One has even heard of instances in which securities of precisely the same class have been held in quite different ways by two neighbouring branches of an amalgamated bank.

If the security be an "Inscribed Stock," that is, a stock the title of which is represented, not by a certificate which must be relinquished on a sale, but by an entry in the books at the office of the registrar of the stock, a letter of deposit is still taken, in order that there may be no misunderstanding as to the conditions as to rate, margin, power of realization, etc., and the stock is transferred into the names of the nominees of the bank, either by personal attendance of the transferor, with identification, or by means of a power of attorney given by the transferor.

There should be no necessity to warn a banker against regarding a "Stock Receipt" as a security, but such a warning is, to my knowledge, very necessary when one is addressing a general banking audience. A stock receipt is useful merely as evidence that the holder of it has bought the stock to which it refers. It has no further use nor value, since it has not to be produced when the stock is sold. A dozen stock receipts, all relating to the same stock, may be in existence in various names.

With regard to the question of what margin there should be between the value of the stock or shares and the amount which the banker will lend against them, no general rule can be laid down. The margin will vary according to the class of security offered. It will be obvious that a much smaller margin will suffice in

the case of, say, National War Bonds than if the security be the shares of an industrial company. In the first case a margin of 5 per cent would suffice; in the latter, anything up to 50 per cent might be required, according to the standing of the company. Not only should the manager make sure that there is a sufficient margin of security when the loan is granted. He should take steps to satisfy himself that such a margin is maintained throughout the currency of the loan.

The advantage to a bank of this particular form of lending transaction—an advance against Stock Exchange securities of a good class—is that the security can always be readily realized in case of need in about a fortnight.

One comes across curious misconceptions at times on the part of borrowers with regard to the nature of Stock Exchange securities. I remember being shown a letter from a customer, addressed to a branch manager, in the following terms: "I shall be glad if you will sell the Japanese bonds which you hold on my account, but I should like to retain the coupons." Such incidents—and it would be easy to relate many such—occasionally light up the gloom in which the existence of a bank official is supposed to be passed.

Advances Against Produce. A great point in favour of these is that they aid the commerce of the country, and at the same time enable the community generally to get food, clothing, and other commodities for their use more easily and cheaply than they otherwise would.

A curious antipathy to such advances is shown by two of the older banking authorities. As Mr. Alfred Williams pointed out in the able series of lectures which he delivered in 1921 before the Institute of Bankers in London (*Journal of the Institute* for 1922, page 7),

Gilbart says: "Another kind of security is bills of lading and dock warrants. Advances upon securities such as these must be considered as beyond the rules which prudent bankers lay down for their own government; they can only be justified by the special circumstances of each case. But in truth, no banker should readily make advances upon such securities. Now and then they may take them as collateral security for an advance to a customer who is otherwise respectable, but if such customer requires such advances frequently, not to say constantly, it shows that he is conducting his business in a way that will not ultimately be either for his own advantage or yet of his customer."

Mr. Williams also quotes Hutchison—a one-time inspector of Parr's Bank, whose book, *The Practice of Banking*, was for many years regarded as a standard work on its subject—to a similar effect: "It will be observed from the forms of the documents known as brokers' undertakings or brokers' engagements in connection with produce, that these are utterly worthless as securities. If assistance by traders is required in this way, the formation of a 'Traders' Loan Company' might be projected, with its object openly professed."

Mr. Williams goes on to quote Sir John Paget, in his *Law of Banking*, in support of advances to honest and responsible customers on such documents of title to goods as Bills of Lading, Dock Warrants, Warehousemen's Certificates, Delivery Orders and the like, and there is not the least doubt that Sir John Paget is right. That Gilbart should have taken the view which I have quoted is not altogether surprising, since his experience of business of the kind must, necessarily, have been exceedingly limited, but that Hutchison, who was familiar with documents of title

to produce and with banking advances against them, should have regarded as worthless such documents of title to goods, is remarkable.

The usual security for advances against produce is a warrant or other commercial document representing the produce. While the consignment is on its way to this country the chief document representing it will be a bill of lading. When the produce has reached its destination and been warehoused, it may be a warehouse receipt, a delivery order, or a warrant hypothecated to the bank after having been endorsed, by means of a letter of deposit, stamped 6d., defining the conditions as regards margin, insurance, realization, etc., under which the advance is made.

Loans against commodities are much more complicated than loans against stock exchange securities. For example, differences of quality may be disclosed if the banker has to realize. After all, in the case of Stock Exchange securities, which we have just dealt with, one £100 of Central Argentine Ordinary Stock, for example, is of exactly the same quality as any other £100 of the stock. Not so, by any means, with bales of cotton, bags of coffee, boxes of tea, bacon or butter, or Chinese eggs. Apropos of Chinese eggs held in security for a bank advance, and held, inadvertently, for too long a period, if time permitted " I could a tale unfold," a tale of what happened when the branch manager of a certain bank who had made the advance and the inspector who had been requested by the head office to accompany him to " view " the security, both having a fair sense of smell, arrived several rooms away from the room in which the eggs had outstayed their welcome.

I remember hearing of a case in which a branch manager of a bank in the newspaper area made a loan

against paper used for newspapers. The borrower failed, and when it became necessary to try to realize the security, it was revealed, for the first time, that the paper was not white, as had been assumed both at the branch and at headquarters, but of a shade used for *The Globe* when that paper was still in being, but, at the time when the borrower failed, no longer in request.

Then, too, in the case of produce loans, there is another risk which is not present in the case of loans against Stock Exchange securities, the risk of deterioration. I remember hearing of an advance against cotton waste, duly insured against fire, and snugly stored in a warehouse under a railway arch, but not insured against what actually happened, the dripping of water through the bricks of the railway arch into the bales of waste, and the consequent spoiling of the bank's security. Rubber, as Mr. Alfred Williams, of the Bank of Liverpool and Martins, has reminded us, tends to get dry and lose weight, and maize " sweats " more freely than other produce of similar class.

I have also been told of an instance in which a bank made an advance against leather (box calf). The summer during part of which the security was held proved exceptionally dry, and partly for this reason and partly because it turned out that the stuff was " vegetal " tanned when it should have been " chromium " tanned, it became entirely worthless.

Also, in the case of produce as security, there is a more frequent risk of fraud. I remember an instance of this which occurred very many years ago and which, for that reason, may safely be related now. A new customer of a bank asked for a loan against a number of cases of sardines. The security clerk, for some undefined reason, did not feel altogether happy about the antecedents of the customer, and asked the manager

of the bank to allow him to go to the warehouse and "view" the sardines. He went, and was shown a number of cases purporting to contain sardines, and one of the cases had the lid off and displayed, amid the usual amount of sawdust, the glittering tops of a number of tins. The bank's representative asked the warehouseman to take the lid off another box, quite at the back of the pile. He did so, and it was found that that box, and all the boxes in the warehouse with the exception of the one which had been already opened when the scrutineer arrived, contained nothing but sawdust! Needless to say, the advance was not made. The only thing connected with this transaction which surprised me, knowing as I did the cautious temperament of the security clerk, was that he had not taken the further precaution of arming himself, on his errand of examination, with a tin-opener, with which to test the contents of some of the actual tins. It may interest and encourage you to know that that security clerk became, in due time, the general manager of his bank.

Notwithstanding the risks I have referred to, and others, loans against imported produce, to substantial and well-known concerns, are a general and satisfactory form of banking advance. I say "to substantial and well-known concerns," for, as Mr. Moxon long ago pointed out, "the intrinsic value of a bill of lading is dependent on the honesty of the shipper. The captain of a vessel only certifies the number and weight of the packages." Such business requires more expert knowledge than many other forms of lending against security. An acquaintance with the mere procedure involved is in itself an education. Such business, however, as already pointed out, is in direct furtherance of the distribution of staple commodities, and is

safely conducted, on a very large scale, both in London and in important provincial centres.

I need scarcely add that the amount advanced to a customer against produce should bear some relation to the amount of his capital. Occasionally, would-be borrowers fail to recognize the reasonableness of this, and are disposed to contend that so long as an advance is covered by produce, with a margin, the amount of their capital is irrelevant.

Advances Against Life Policies. Despite some opinions to the contrary, the assignment of a life policy is a good banking security when the life office is a well-established and successful concern and when the amount of the advance does not exceed the surrender value of the policy, which may be ascertained from the office.

It may, in certain circumstances, also be a useful form of security or additional security to take when the safety or repayment of an advance depends on the continuance of the life of the borrower; when the business, for example, is a "one-man" concern. When a banker has decided to surrender a life policy which he holds as security, he should defer surrendering it until as near as possible to the date when the next premium is due. It is always possible that the customer may die during the interval.

A real drawback of a life policy as a banking security lies in the fact that such a policy is, in many cases, the only form in which a man has provided for his wife and children, and the realization of the security, should the time come for falling back on it, may entail on the banker an odium which, in common with most other lenders against a similar security, he would naturally prefer to avoid.

An assignment of a life policy being in the nature of

a mortgage, the bank's form of assignment has to be stamped at the rate of 2s. 6d. per cent on the face value of the policy, and notice of the assignment should be given to and acknowledged by the life office.

The receipts for the premiums should be exhibited to the bank periodically, to show that the policy is being kept alive.

I need not tell you that a fire policy is not a banking security. Nevertheless, I have known a case in which such a policy has been offered to a bank. The reply of the branch manager was, " A fire policy ! and when is the fire going to be ? "

Advances Against Personal Guarantees. A guarantee is a form of security frequently taken, and may be regarded, generally, as quite legitimate from a banking standpoint. Before taking it the banker naturally satisfies himself, by inquiry from a banker or otherwise, that the proposed guarantor is quite good for the obligation, and during the continuance of the advance against it he satisfies himself, from time to time, as to the guarantor's continued sufficiency. He also takes the necessary steps to satisfy himself that the person who presents himself to sign the document is the person who has been held out to him as the proposed guarantor. A neglect of this elementary precaution has, in some instances, led to unfortunate results.

In cases where there is any doubt as to the sufficiency of a proposed guarantor, he should be requested to put in collateral security.

In point of liquidness, however, an advance against a guarantee cannot be regarded quite so favourably as a loan against the securities we have so far discussed.

As a rule, no one enters into a bond for another man with the idea that he will have to pay up. Witness the

classic instance, in "The Merchant of Venice," of Antonio and the pound of flesh. In the ordinary case, a guarantor is assured by the friend for whose debt he makes himself contingently responsible that his entering into the obligation is a mere matter of form. Consequently, when the borrower fails to repay the advance, the guarantor is naturally reluctant to meet an obligation which he has entered into out of friendship or acquaintanceship.

A drawback of a guarantee when it is entered into by a customer of the bank for another customer is that the guarantor customer sometimes resents being called upon by the bank to pay, and the result is a coolness between the parties and possibly a loss of the account and all connected accounts.

An obvious general drawback of a guarantee as a banking security is that, after an advance has been made against it, the financial position of the guarantor may so deteriorate that the value of the security becomes doubtful.

When the guarantee of a woman is taken, it is desirable that she should be independently advised by her solicitor and that he should be the witness to her signature to the document.

The circumstances in which a guarantee may be most satisfactorily used as a security is in the case of an advance to a limited company. The guarantee of the directors may, possibly, not be necessary from the point of view of the safety of the advance, but the fact of having given it gives the guarantors a personal interest in the speedy repayment of the debt. They are anxious to get rid of the contingent obligation at the earliest possible moment.

There are so many pitfalls in guarantees that the bank's own printed form of guarantee should be used.

The stamp on a guarantee by an individual or firm is 6d. only. A guarantee by a limited company, given under seal, should be stamped 2s. 6d. per cent.

Advances Against Deeds of Property. I need not tell you that land is not a banking security, or that real property should, as a general rule, be lent against only to good borrowers and for limited periods; say, to bridge over a short period when the source of repayment is known and the means of repayment is in sight; for example, pending the completion of a mortgage which the banker is satisfied is in course of arrangement. If the proposed loan against such security can only be repaid by instalments spread over long periods, the proper course for the borrower to adopt is to obtain a mortgage through a solicitor, or from a building society.

Even temporary loans against the title deeds of property, pending the arrangement of a mortgage, may prove troublesome, though perfectly legitimate. It is often found that a solicitor has almost completed the arrangements for a mortgage, when the proposed lender, the intending mortgagee, dies, or is alleged by the borrower to have died. I have sometimes felt disposed to suggest, as a suitable subject for discussion by the Institute of Actuaries, which makes a special study of mortality matters, " The rate of mortality of intending mortgagees."

Then, too, a banker is frequently told, apropos of mortgages in course of arrangement, " The solicitor who has this matter in hand is on holiday," or (more frequently) " is ill, and unable to attend to business." Here, again, one has felt tempted to suggest as a subject for discussion, this time by a medical congress: " The peculiar susceptibility of solicitors, as a class, to the sudden inroads of disease."

Even when a solicitor has escaped these risks, a customer, in explanation of a delay in completion, often says, " My solicitor tells me he has the matter well in hand, but you know what solicitors are ! " Kindly note, here, that I by no means associate myself with this implied libel on a whole profession.

However, loans against houses, shops, etc., constitute the majority of advances at many branch banks, and provided that due care has been exercised in granting them and that they are not likely to be unduly prolonged, they are legitimate enough. Weekly cottage or house property, though, is generally undesirable security, as are, in these days, very large mansions.

Before the title deeds of property are advanced against, two things at least are necessary.

There should be (1) an examination and valuation of the property, at the expense of the customer. This may either be entrusted to a competent professional valuer, or carried out by the bank's local representative. Personally, I am a strong believer in local bank managers, when they know their business and their district, as valuers in ordinary cases; and (2) a report on the title to the property, by a solicitor acting on behalf of the bank. The valuation should always be on the basis of a forced sale. This for obvious reasons.

If both these prove satisfactory, there are various methods of hypothecating the security to the bank. I will give them in order of stringency.

1. The bank's printed form of mortgage, which has to be stamped 2s. 6d. per cent.

2. The bank's equitable charge over the property, in the form of a letter of deposit, under hand, containing a " Power of Attorney clause " which renders the document liable to be stamped 2s. 6d. per cent.

The power of attorney clause appoints an official of the bank, say the general manager for the time being, as the attorney of the borrower in certain contingencies.

3. The bank's equitable charge in the form of a letter of deposit, under hand, stamped 1s. per cent.

The drawback of using this last-mentioned form is that if circumstances arise which render it necessary for the banker to enforce his security, he may have to go to the court for the necessary powers.

Different banks adopt different methods in this matter. The same banks, even, adopt different methods in different areas. There are cases in which a bank, having, in the first instance, taken a letter of deposit only, finds it advisable, at a later stage, to get the borrower to execute a legal mortgage. This the borrower undertakes, in the letter of deposit, to do on request.

"BORDER-LINE" SECURITIES

I now come to a different category, namely, securities as to which special caution should be exercised, and the circumstances connected with which should be very fully investigated, before an advance is either recommended or made. There is an excellent chapter on these, under the heading "Securities which are not Security," in *The Country Banker* (John Murray) by the late George Rae.

First among such securities, by reason of the frequency with which they are offered, I would place second mortgages.

Second Mortgages

Presumably the customer, when he borrowed against a first mortgage of the property in question, was allowed to borrow only as much as the mortgagee

thought it prudent to lend. Why, therefore, should a banker show less prudence, and make a further advance on the property?

Moreover, the first mortgagee's only interest in the matter, when he wants his money back and has given due notice of that fact, is, if the borrower cannot find the money, to sell the property for enough to repay himself. He has no interest in the bank getting repaid.

Next I would refer to mortgages on ships.

Mortgages on Ships

Without going so far as to say that a banker should never lend against a mortgage on a ship or a part of a ship, one may say with confidence that such advances should be made only with the utmost care and after the fullest consideration. Mr. Stead, in his useful and practical book, *Bankers' Advances* (Pitman), considers that "fluctuating advances to owners on the security of ships, assuming such advances are in character with the customers' capital and with the extent of their business, may be regarded as entirely legitimate." This, however, was written in 1919, before the bursting of the shipping-boom bubble—a contingency the possibility of which the author, with commendable perspicacity, foresees in another passage.

One sees it stated that quite a number of losses were made by banks, when the shipping-boom broke, through having lent against ships, and this, too, notwithstanding the fact that in addition to taking mortgages over the ships, the various banks concerned are said to have obtained additional cover in the form of guarantees by directors of the borrowing companies who were most satisfactorily reported on at the time their guarantees were given.

What occurred was that, in the early nineteen-twenties, the value of ships generally fell to a fraction of the price at which they were purchased, and what is alleged to have occurred is that in many instances the directors of the companies which owned the ships found themselves in greatly reduced circumstances and quite unable to meet their obligations under their guarantees.

That there is some truth, at least, in this last allegation appears to be shown by a perusal of the bankruptcy proceedings in the public press.

Be this as it may, bankers are more cautious now than they were just after the War about lending against ships, and with reason. Apart from the possibility of rapid depreciation in the value of the ship, there are all sorts of further risks which the banker, no matter how cautious, cannot altogether avoid if he once makes an advance of this description. For a statement of some of these I would refer you to Mr. Stead's book to which I have just referred, but I may say they include the possibility of the master of the ship, in a foreign port, hypothecating the ship under a bottomry bond, and even, on the occurrence of certain contingencies, selling both ship and cargo, to say nothing about irritating claims from all sorts of sources which the bank, if the borrower should be unable to do so, may have to meet in order that its security may not be impaired.

Possibly it will be thought that I have drawn somewhat too gloomy a picture of the risks run by bankers in making advances against ships. There are still, it is true, companies and firms engaged in shipping which are able to command such advances and to whom they may be granted with safety, but I repeat that the greatest discrimination should be shown.

Such advances, when granted, are made against a bill of sale over the ship, and this has to be registered at the ship's port of registry, and it is well to supplement the document by a memorandum, somewhat on the lines of the "letter of deposit" which a bank uses in the case of advances against produce, dealing with such matters as insurance, etc. Whether a personal guarantee should be asked for in addition will be for the banker to decide in view of the standing of the borrower and other circumstances.

Charges on Uncalled Capital. Advances on the security of such charges are somewhat on the border line of desirability, but in many instances they are an obvious convenience to a company and may be safely made as a temporary matter. In such cases the banker asks to be furnished with a list of the shareholders, together with the number of shares held by each, and satisfies himself, by inquiry or otherwise, as to the sufficiency of at any rate the larger shareholders for the amount for which they are liable. It is well to stipulate for a fair margin between the amount of the loan and the amount of the uncalled capital, and the charge taken over it by the bank should be prepared by the bank's solicitor and should be registered at Somerset House within twenty-one days after its creation. It is the duty of the company to register the charge, but, if necessary, the bank as mortgagee can register. Before such an advance is made, care should be taken to ascertain whether the company has debentures outstanding.

Reversionary Interests. These, as I have said elsewhere, are quite a legitimate security for an insurance office, but not for a banker. The falling in of the reversion may depend on the death of someone who may live for many years, or on a mere child attaining his

majority. Advances against reversions are too much of a "lock up."

Assignments of Retention Moneys. As many of you will know, when a contract—say for erecting a building—is being carried out, it is usual for the person who has given the contract to pay the contractor by instalments, on the architect's certificates, deferring the payment of an agreed percentage of the contract moneys until the whole of the work has been satisfactorily completed.

A somewhat similar arrangement is frequently made with regard to contracts of other kinds; contracts, for instance, for the supply of successive consignments of goods. A certain proportion of the price of the goods is paid as each consignment is delivered, but a proportion is withheld until all the goods have been thoroughly examined and pronounced satisfactory.

A builder or merchant who has obtained contracts of such a nature as these will often, if he be short of funds, offer a charge over these "retention moneys" to his banker as a security, but it cannot, as a rule, be regarded as satisfactory.

If the contract to which such a security relates be not satisfactorily carried out, the retention money may be either forfeited or greatly diminished in amount. In the first case, the security becomes valueless; in the second, its value is proportionately decreased.

Unquoted Shares. You may be told that although these are not quoted in the Stock Exchange Official List, there is a local market in such shares or debentures, but, as a rule, it is unwise to rely on such a market; for the reason, amongst others, that you have not the same opportunity of watching the quotation as you have in an official list, published daily.

Mill, Factory and Mining Properties. Mills and

factories are "specialized" security, as a rule; that is, the buildings are suitable for one kind of manufacture only, and are therefore saleable only to persons or companies engaged in that particular branch of industry. There are, however, exceptions.

Mines, as a security, are obviously subject to many risks. The mine may be flooded and rendered unworkable. Even the miners' cottages, which may be included in the security, will probably be rendered worthless if the mine stops working.

Nevertheless, in certain exceptional cases, advances against a debenture over a coal mine have been made over and over again, and as frequently repaid. There are mines *and* mines. In the present state of the coal industry special care is needed.

Brickfields. These are what is termed a "wasting" security. The more industriously they are worked, the less valuable they become. Banks in certain districts where brickmaking is extensively carried on have had, in the past, good reason to realize this.

Buildings in Course of Erection. As you will have heard remarked elsewhere, you do not wish to become a builder as well as a banker, and there is always a risk that, in order to get your money back, you may be forced into such a position. There are, however, cases in which this general rule may safely be relaxed; when, for example, the applicant for an advance is a substantial and reliable man and the house (if it be a house) is roofed in. There are growing towns where bankers are believed to have quite a fair amount out in loans of this description, and this without more than an ordinary banking risk. It depends mainly on the ability, judgment and means of the borrower.

Shares Involving a Liability. These are shares not fully paid up, but this definition, however, needs

considerable qualification. Some shares of this description, such as those of good insurance companies, are quite a good banking security. If such shares should be advanced against, they should not be registered in the name of the bank or its nominees, because if they be so registered, the bank or its nominees will become liable for the payment of further calls which may be made, and what has been taken as a security becomes a liability.

Curious forms of security are sometimes offered to a banker. Apart from the fire policy to which reference has already been made, one has known a case in which a bank customer has offered three sixty-fourths of an unseaworthy ship and one share in the company which owned a newspaper which had ceased to exist, whilst foreign lottery tickets are frequently tendered by customers who are, apparently, unaware of their nature. One has even known an instance in which a branch manager, after listening to a long tale of the need for accommodation, has been offered a pianoforte as security.

After this rapid review of some of the numerous forms of banking security, suitable and questionable, I propose to enter into the consideration of another branch of lending—the question of unsecured advances.

UNSECURED ADVANCES

Most bank advances, whether in the form of loan or overdraft, are secured, but there are exceptional instances in which the financial position of the borrower, or the special circumstances of the case, justify the banker in foregoing security, and allowing accommodation without cover of any kind. On the whole, uncovered advances are less frequently allowed in London than in the provinces, possibly for the reason that, as

a rule, the provincial banker is in much closer personal touch with his customers. A City manager in London necessarily sees less of his customers personally, apart from business, than a provincial manager, who meets them in various other relationships.

Take, first, the case of an individual or firm requiring such an advance. The usual course is to ask to see a balance sheet or other signed statement of the customer's financial position. In any case, it is well for a customer who wishes to obtain credit in any direction to take his banker into his full confidence with regard to his financial position. For one reason, amongst others, the banker is often asked, by other bankers, on behalf of their customers, for an assurance as to his customer's financial standing.

Examination of a Trader's Balance Sheet. Take, as an example, a simple signed statement of the affairs of an individual trade borrower, say a draper in a very small way of business. He wants £500, without security, to enable him to buy stock and secure a good discount from the wholesale house. At your request, he submits a statement of his affairs which he has himself drawn up. It is as follows—

Liabilities	£	*Assets*	£
Open Accounts	500	Sundry Debtors	1,000
Bills Payable	750	Stock in Trade	1,200
Surplus or Capital	1,600	House Property	300
		Fixtures and Furniture	250
		Life Policy	100
	£2,850		£2,850

Now there are two ways of dealing with a balance sheet when it is submitted to a branch manager. One is to take its correctness for granted, and forward it to head office with the application for an advance.

This is what, at headquarters, we call the "open-your-mouth-and-shut-your-eyes" method. The other is to go through the statement with the customer first, item by item, asking such necessary questions with regard to any of them as your experience in similar cases suggests.

Let us run through, in this way, the balance sheet put forward in this case.

Take the "Assets" items first, beginning with "Sundry debtors, £1,000." Are these debts, owing to the would-be borrower by his retail customers, all quite good? Have no customers been known to leave the neighbourhood without "beat of drum" and without discharging their debts? It would be well to allow 10 per cent for possible bad debts, and to carry out this item as £900.

Now take the next item—"Stock in trade, £1,200." Remember, it is a draper's stock, and for that reason more liable to depreciation than that of certain other businesses. Ask your customer on what basis he has arrived at the figure given; whether the stock is valued at cost, and if not, how. Beware, too, of the "round figure" method of taking stock, as well as of stating other items, and beware, also, of the man who "never has time to take stock." If he wants to know how he stands financially, and especially if he is asking for banking accommodation on the strength of his position, it is his duty, to himself and to his banker, to take stock periodically and on a rational basis.

This man's stock, it appears, is valued "at cost." This, as already suggested, might be allowed to pass in some businesses, but not in a draper's. What about goods which have gone out of fashion, or become "shop-soiled"? Consequently, you attribute to this item a "forced sale" value of £600.

The next item is "House Property, £300." You ask whether there happens to be a mortgage on the house, and you find that there is one of £200, so you write down the amount to, at the most, the value of the equity, namely, £100.

Incidentally, your customer is not a rogue. He is simply unbusinesslike in financial matters.

Then you come to "Furniture and Fixtures, £250." Have any of you, in removing from one house to another, had any experience of what the item "fixtures" will realize when the proposed purchaser knows you cannot utilize them in your new abode? In the light of such experience, we will write this item, in the present case, down to £100.

Then comes "Life Policy, £100." This, it appears on inquiry, is the face value of the policy, and although the customer is an elderly man, he has only recently taken it out, and you are able, from the amount he tells you he has paid in premiums, to estimate its surrender value as £10.

By this process, the assets valued by the customer at £2,850 have been reduced to £1,710.

Now turn to the "Liabilities" side. "Open accounts, £500." Has your customer no other obligations? No guarantee, for instance? Yes, he has given a neighbouring branch of your bank (as you happen to know) a guarantee for £500 on behalf of his son, who is in a business which you know is not at all flourishing. You ask a question as to this, and are informed that the son is not doing well. "Young men, nowadays, are very different from what they were in my day," etc. The father assures you, eagerly, that he has not yet been called upon to pay under the guarantee. You sympathize, sincerely, with the customer as a father, but add £500 to his contingent

obligations in connexion with his guarantee for the son.

The item "Bills payable, £750" may stand, and, summing up the obligations shown in the amended balance sheet, you find that they amount to £1,750. It will be remembered that your revised valuation of the assets was £1,710, so the result is a deficit of £40, which, clearly, does not justify an unsecured advance.

I suppose I need not tell you that a balance sheet containing so many doubtful or misleading items as this has never come under my notice. I may say, however, that the kind of mistake or over-estimate which occurs so frequently in this entirely imaginary balance sheet has, by itself, occurred again and again in balance sheets which have come before me.

If any of you feel disposed to describe this scrutiny of a balance sheet as somewhat "cold-blooded," the reply is that banking is a business which should be conducted with the head, not the heart. What you have constantly to remember, when considering applications for advances, is that it is not your own money, but money entrusted to you; the money of the shareholders; which you are asked to lend. There are cases in which, if the money were one's own, one would be inclined to lend it, but in which one does not feel justified in lending the money of the bank.

I should like to add here, parenthetically, that if you wish to have further illustrations of how a would-be borrower's balance sheet should be dealt with by a banker, you will find plenty of them in a very useful book written by Mr. Francis R. Stead, *Bankers Tests* (Pitman). In this book Mr. Stead takes a large number of typical proposals for banking accommodation of various kinds and examines them in the light thrown

upon them by the balance sheets which accompany them and by his own experience as a lender.

The last case dealt with was that of an individual trader asking for a loan without security. We now come to another class; to limited companies.

Unsecured Advances to Limited Companies. The first thing to be done, when a company requires an unsecured advance, is to obtain a copy of its most recent audited balance sheet.

Examination of a Company's Balance Sheet. It is an advantage to get copies of the balance sheets of a few previous years in addition, for these will show the position progressively. Apart from the balance sheet, you will also satisfy yourself with regard to the borrowing powers of the company and as to the extent to which they have been exhausted. Information on the first of these matters may be gained from the company's Memorandum and Articles of Association, and on the second by means of a certified statement on the point.

A very important matter, in dealing with the balance sheet, is to ascertain whether the company has issued debentures. A debenture is a very "Aaron's rod" in its swallowing capacity when a company goes into liquidation. It absorbs a far larger quantity of assets than, apart from experience, one would think. Satisfy yourself, therefore, that there are ample assets over and above those necessary to satisfy the debentures.

Incidentally, if you are considering an application for a secured advance to a company which has issued debentures, satisfy yourself also that the security offered is not included in the scope of the debentures. Companies frequently, and quite innocently, offer securities which are so included.

Then, look out for the item "Goodwill" and knock

it off, and, if this item be mixed up with other items, in one total, ascertain its amount and knock it off. The goodwill of a prosperous concern is, of course, a valuable asset, but in the event of the company coming to grief—and this is a contingency which has always to be borne in mind—it is clear that its value may easily be negligible.

Further, look out for the item " Preliminary Expenses " and deduct it. I need say nothing as to what, in any case, this " asset " would realize " under the hammer."

With regard to the item " Machinery," ascertain the extent to which it has been written down. It should, of course, be written down progressively, year by year, or half-year by half-year. Take it at " forced sale " price ; sometimes even at " scrap iron " price. To this, however, there are exceptions. Copper rollers, for instance, which are used in certain processes of manufacture, deteriorate very little, and there are, even, some machines which, since the War, have considerably appreciated in value. Even these, though, will of course have to be " written down." The appreciation is transient.

In the way suggested, go through every item on both sides of the balance sheet. Write down the " Assets " items and carry out your idea of their value, basing it on your experience of this and similar businesses. Run through the " Liabilities " items and do likewise. Then strike a fresh difference, showing your own ideas as to the amount of the surplus. This is the " break-up " surplus, the surplus against which you can safely lend.

Skill in analysing a balance sheet is one of a banker's first qualifications. I have, in my younger days, on several occasions, seen a company's balance sheet

analysed by my general manager in a manner which seemed to me, at the time, most drastic, even merciless, but have lived to see his analysis absolutely justified by the event.

Here is an interesting and important point. Having, as it were, struck a fresh balance between assets and liabilities, and having brought out the real surplus from a lending banker's point of view, what proportion should the amount which the banker may safely advance without security bear to that real surplus? Very conservative bankers would say one-tenth, but I regard that as unduly conservative. If the proposed advance is to be fairly temporary, I suggest that a fourth or a third of the amount of the surplus may be safely lent.

A standard American work already more than once referred to (*Bank Credit*, by C. A. Phillips, The Macmillan Company, New York) puts the matter as follows: "It is maintained in banking circles that unsecured loans should not be made greatly to exceed one-third of the net worth where the banker is well acquainted with the business ability and morals of the borrower. Nevertheless, the ratio varies widely from banker to banker, and from borrower to borrower. Even the bank balance maintained by the applicant for a loan will be one of the determining factors. No hard and fast rule can be laid down."

If you are not satisfied, from your scrutiny of the balance sheet, that an unsecured advance is justified, try to get a debenture, covering the assets, or the guarantee of the directors, or even both. It is, of course, frequently the case that directors of companies do not like giving a debenture. Such a course involves registration and publicity. Also, directors often dislike giving their personal guarantees, but with regard

to this last objection, it may be necessary to point out that while the debenture covers assets which are of sufficient value ultimately to repay the advance, such assets may take a very long time to realize, and that in such a case a guarantee will prove a useful additional security. It gives the guarantors a personal interest in the timely repayment of the advance. If repayment is likely to be too protracted, the guarantors should pay up, and repay themselves by the gradual realization of the assets. Further, with regard to the not unnatural reluctance of directors to guarantee personally an advance to their company, it may be remarked that if they are perfectly satisfied as to safety of the advance, they run no risk in guaranteeing it.

BALANCE SHEETS GENERALLY

Having gone through two specimen balance sheets, one of an individual trader and one of a limited company, I now propose to make a few further suggestions with regard to the scrutiny and analysis of balance sheets generally.

I consider that Dr. Phillips, to whose work, *Bank Credit*, I have already referred, sums up this important branch of the lending banker's function better than any other banking writer whose books I have come across, and for this reason I strongly recommend those who wish to go more fully into this matter to read his views on it. They are given in considerable detail, and are exceedingly well thought out. As he says, there are two points, amongst others, to consider, in connexion with a balance sheet. The first is, does the statement show a reasonable likelihood of the proposed loan being repaid at maturity ? And the second is, if circumstances should prevent its being paid at

maturity, will it be paid ultimately? In other words, is it liquid, and if, unexpectedly, it should prove to be less liquid than anticipated, will the banker avoid making a loss?

As Dr. Phillips suggests (*Bank Credit*, page 162), the answer to the first of these questions depends largely on the relation of the borrower's "quick" (i.e. liquid) assets to his current liabilities, and the answer to the second depends on the relation between his "slow" or permanent assets and his permanent liabilities. "Current liabilities" must be met out of "quick" assets. Permanent liabilities should be fully offset by slow or permanent assets.

PRELIMINARIES TO ADVANCES

Many of you know that banks supply blank forms of different kinds to different classes of borrowers.

Preliminaries to Advances to Farmers. An application form, for example, supplied to a farmer who asks for an overdraft, begins by asking what is the acreage of his farm, and how much of it is arable. It goes on to inquire the name of his landlord, the amount of his rent, and whether the rent is paid up to date. Then come spaces for the number of his dairy cows, fat cattle, young beasts, horses, pigs and sheep, with further spaces, in each case, for the value, per head, of each, and the total. Information is also sought as to the value of his implements, and of his wool clip. Then come spaces for such items as harvested stocks of hay, straw, roots, wheat, oats and barley. Then further spaces for the value of his book debts, life policies, property, shares, and "any other assets." This completes the "assets" side.

Then come the liabilities. Information is asked as to what is owing to the bank, to his landlord, to auctioneers,

to those who have supplied him with seeds and foodstuffs, to relatives, and to other possible creditors. It will be observed that practically every kind of asset and liability is thus provided for, and in such a way that a man with a sluggish memory or unbusinesslike habits cannot fail to be reminded of items which he might otherwise easily forget.

Both assets and liabilities are summed up (it is well that the banker should perform the addition, or at any rate, check it, for some farmers, like some lady golfers, are poor arithmeticians) and the net capital is revealed, the would-be borrower signing the statement.

Dwellers in cities may be disposed to regard such a form as this as unduly detailed and inquisitorial. If they had any experience of lending in an agricultural area, they would modify this view. Not only is such a form as has been described necessary and exceedingly useful, but the branch manager frequently has to fill it up himself, the applicant supplying him with the information for the purpose and signing the document when it has been completed.

Preliminaries to Advances to Traders. The form supplied to an ordinary trading borrower is, of course, different. On the liabilities side are spaces for his liabilities on acceptances, on guarantees, on open accounts, to the bank, and for "other liabilities."

On the assets side, spaces are provided for book debts, stock in trade, property ("as per list") and life policies (nominal amount and surrender value).

With regard to the properties, spaces are left for particulars of whether they are freehold, leasehold or copyhold, and for such details as the consideration (with date), the amount of mortgage, the amount of ground rent, and the amount for which insurance has been effected against fire.

The items are summed as before, and the balance of capital is brought out.

In the case of a limited company, it is not usually necessary to supply a form, since the company's own audited balance sheet, with such supplementary explanations as the managing director or secretary may supply at an interview, should suffice.

BORROWERS' ASSETS—LIQUID AND OTHERWISE

Among the more liquid assets, in the case of a trading or manufacturing firm, will be, apart from cash, money due on open account; that is, the total of running accounts representing a balance due to the bank's customer from such customer's customers; bills receivable, that is, bills of exchange accepted by purchasers from the concern and payable to the bank's customer, and marketable goods ready for sale.

Among the less liquid assets are goods in process of manufacture, plant and machinery, and factories and other buildings used for manufacturing or trading purposes.

Apropos of the less liquid assets of a company, the distinction between factories on the one hand, and warehouses on the other, may be noted. A factory may be suitable for one kind of manufacture only; a warehouse may be suitable for many kinds of trade.

Turning now to the other side of the statement, we pick out the current, or more pressing, liabilities. These are bills payable (i.e. bills accepted by the borrowers, and falling due within a short period) and debts owing by the concern on open account.

The "permanent" liabilities may include amounts lent to the firm by relatives or employees,

money left in the firm, at interest, by former partners, and mortgages or other charges on property.

The weak point of the first two of the last three items is that, although the banker may be satisfied that the employees or relatives of late partners have agreed not to withdraw their money without giving long notice, he is also well aware that, in the event of the firm being in difficulties, the relatives and ex-partners frequently have opportunities of learning, in advance, of the trouble, and, human nature being what it is, will not hesitate to use that knowledge to advantage. They will suddenly discover that they want to buy their houses, or set their sons up in business, and so forth.

Having separated the liquid assets of the concern from the permanent assets, and the pressing liabilities from the less pressing liabilities, we proceed to weigh up the liquid assets on the one hand, against the pressing liabilities on the other.

In this connexion, it will not suffice to do what there is always a tendency to do, set off a given amount of current debts owing to the concern against an equal amount of current liabilities. An allowance must, as in the case of our draper's balance sheet, be made for bad debts among the amounts owing to the concern, and to this end the borrower should, if the banker deem it desirable, be asked to furnish a list of his debtors, in order that the lender may satisfy himself as to their sufficiency for their obligations. In some cases the banker knows, from experience, that the debtors are good, and does not trouble the borrower to produce a statement.

If the banker be satisfied that the more liquid assets are ample to meet the more liquid liabilities, the more difficult part of his task is accomplished. He can then proceed, in the manner indicated a little earlier,

to estimate whether the total assets, "pruned" to meet his views, are more than sufficient to meet the total liabilities.

But the inquisition does not necessarily finish with the filling up and explanation of the balance sheet. Further inquiries are in store. The production of the trading account and the profit and loss account may be required, by reason of the light they may throw on the balance sheet. There is a tendency on the part of the trader, often quite an innocent tendency, to "pad" his profits by capitalizing expenditure on repairs and maintenance, instead of charging those items off as current expenses.

One more point must be mentioned in connexion with the customer's financial position, and that is, what is the amount which he draws from the business, and what relation does that amount bear to his profit for the year? Excessive drawings for ordinary living expenditure are, of course, a sign of extravagance and a note of warning, but it is often found that drawings which are apparently excessive are for such laudable purposes as investment in Government stocks or in other tangible security.

The banker should beware of the profit and loss statement which shows progressively increased profits every year. The trader, it is true, *may* be so fortunate as to go from strength to strength, but it is the way of most trades to be alternately more and less profitable. Much, naturally, depends on the nature of the business. Trade prosperity, as we all know, generally goes in cycles or in curves; it rarely progresses in a straight line.

Whenever possible, the presentation of a balance sheet by a borrower should be accompanied, or supplemented, by a personal interview. A five minutes'

interview is worth any amount of correspondence. To the shrewd lender, it reveals character and business capacity, and these, together with capital, are the three main factors in enabling the banker to make up his mind whether the proposed advance should be made.

To sum up, in this lecture I have directed your attention to certain fundamental principles in lending; have reviewed the various kinds of security, desirable and otherwise, most frequently offered to bankers, and have dealt with borrowings by individuals and companies on the strength of their balance sheets, indicating how those balance sheets should be analysed and how balance sheets generally should be dealt with. Now just a few words as to the effects of recent banking developments, and especially bank amalgamations and working arrangements, on the facilities for borrowing accorded to bank customers.

It is my belief, founded on a fair amount of experience in such matters, that since the concentration of banking business in the hands of a few large and well-managed institutions with wide ramifications, the small borrower has found a willing lender nearer to his door, while the large borrower has found in his banker an equally ready lender with ampler resources than of old.

CHAPTER IV

SOME INTERNAL CHECKS ON LENDING AND SOME MAXIMS FOR LENDERS

Tests of loan applications—The branch test; transforming proposals—Head office tests; scrutiny by officials and directors; scrutiny by inspectors—Some maxims for lenders—Advances for "fixed" capital purposes—Seasonal advances—"Sticky" advances—Discounting optimism—Stereotyped opinions on borrowers—"Seaside" finance—Life renters—Personal interviews—Difficult points first—Advances on joint accounts—Correspondence with and about borrowers.

Having laid down, earlier, the principle that bank advances must be safe, liquid, proportionate to the amount of liabilities, and profitable, it will be useful if I proceed to explain the tests by which these desirable characteristics are, first, ensured at the inception of a loan transaction, and then maintained during the currency of the advance.

It will be remembered that, at the outset, I promised (or threatened) to look at these matters from the head office standpoint, and this promise (or threat) I now propose to carry out further.

THE BRANCH TEST FOR LOAN APPLICATIONS

Take the case of a proposal for accommodation received by head office through a branch. Head office has the right to rely on its local manager to satisfy himself, before submitting the proposed transaction to headquarters, that it fulfils three of these requirements, the second, the question of the proportion of the bank's advances to its liabilities, being clearly a matter for the head office only.

May I, in this connexion, quote from a chapter of

my own on "Bank Managers and Borrowing Customers" (*Present-Day Banking*, Butterworth & Co.).

> Not the least of a manager's difficulties arise in connexion with the proposals for advances to which he has to lend a sympathetic ear. At many branches the number of proposals which are really good business bears but a small proportion to the total number of applications received. With proposals on the right lines, there is, of course, no difficulty in dealing. Where the security, the duration of the accommodation, and the rate of interest, are all fair and acceptable to both parties, the business "does itself." The completion of the trasnaction is merely a matter of routine. At the other end of the scale are the offers of business which the manager at once sees to be impossible. In this category are unsecured advances to customers who are either impecunious or decline to give any indication of their financial position; advances against property on which there are prior charges; loans against assignments of book debts "without notice"; advances to contractors against retention moneys in the hands of corporations; and so forth.
>
> In between these two classes of proposals, however—between the very good, and the quite impossible—there comes a very large class of applications which, although unacceptable in the form in which they are, in the first instance, brought before the manager, may be knocked into an acceptable shape; and it is this transmitting process which affords one of the best evidences of a manager's fitness for his post. Anybody can grant, or submit to his head office, a perfectly good proposal. Anybody can decline a transaction which is obviously impossible. Where the real skill of a bank manager proves itself is in getting a borrower so to modify an impracticable proposal that it will assume a shape in which it will be acceptable to himself and to headquarters. Many a would-be borrower has gone away unsatisfied, and many a valuable account has been lost, simply because the manager to whom the application for accommodation has been made does not know his business in this respect; does not know that it is, in many cases, possible so to transform a crude application for an advance that it shall lead to business which will be both safe and profitable for the institution which he represents.

That is to say, if, when the proposition is placed before the branch manager, it appears to him to be lacking in any of the three elements of safety, liquidness or profitableness, it is for him to get the would-be borrower so to modify and improve it that it may comply with all three tests and be sent on to head office with a clear conscience.

This is test number one, which is applied to all branch proposals. I may add that it is also one of the

tests applied by headquarters to the branch manager himself.

HEAD OFFICE TESTS FOR LOAN APPLICATIONS

The second ordeal through which the proposal passes is the scrutiny of the officials at head office. Their views as to the safety, the liquidness, or the profitableness of the transaction may not be on all fours with the local view, and there may have to be correspondence or interviews with the manager or the borrower in consequence. The manager, being in close personal touch with the customer, is naturally appreciative (as he should be) of the customer's standpoint, whereas head office is perhaps disposed to look at the proposal more strictly on its merits.

The third test, in the case of larger advances, is applied by a committee of directors and officials which, in practically all the large joint-stock banks, meets daily at head office in order to go into these and other important matters. Sound lending is a matter of such importance that the larger advances are regarded, very properly, as a matter for serious consideration.

A fourth ordeal, in some banks, takes the form of another committee of directors and chief officials, which meets, say, weekly, and reviews and criticizes all fresh advance transactions over a certain figure. They are read out, one by one, and are closely scrutinized and considered by the directors present.

A fifth test, in some institutions, is applied on a somewhat different basis. A committee of directors, with a head office official, meets weekly, and goes through, one by one, not the large advances only, but all the advances over a given amount (often quite a low figure) which are outstanding at the branches.

You will have observed that the first four of the tests mentioned are applied to advances which are either quite fresh or, at the outside, a week old. This committee examines all advances at the branch under review, both those which have been recently made and those which have been current for a considerable period. You see, a loan may be perfectly safe when granted, but may become less safe as time goes on. The security may depreciate. The borrower may "depreciate"; he may take to drink, or to speculative transactions. It is, of course, the duty of the officials in the advance department, as well as of the branch manager, to guard against such contingencies, or rather, if they should arise, to take suitable steps to safeguard the bank's interests, and it is for the directors on this committee to satisfy themselves that the officials have performed this duty, and also to see that temporary loans are not allowed to degenerate into permanent advances. Dormant and "sticky" overdrafts which may have escaped the attention of managers and eluded the vigilance of controllers may thus be brought to light, and either called in or placed on a proper basis. The process is somewhat tedious, but it is nevertheless worth while.

In some banks a sixth test is applied. A few weeks before the end of each half-year a sub-committee of the loans committee, consisting of one or two directors, is appointed by the board to go through, with the manager, the large advances at the principal offices of the bank, with a view to ascertaining whether they may be regarded as quite liquid and safe, and, if not, to recommend the course to be pursued, or a provision against possible loss. This sub-committee usually reports to the full loans committee, which takes such action as it deems necessary.

A further test, constantly in operation in the case of some banks, must be mentioned, for in some of its aspects it is the most searching of all. This is the examination of advances by the bank's inspectors when they visit the various offices. The practice of banks varies considerably in this respect. The standing instructions of some banks to their inspectors in the matter of advances are that they are merely to see that the loans and overdrafts and discounts and negotiations are in accordance with the minutes or sanctions from head office, and that the securities are properly charged.

Other banks instruct the inspectors to report independently to the directors on all the advances of the branch they are visiting, with full particulars as to security, rates, etc., and to give an opinion on any points connected with such advances which they consider worthy of special note.

In the first of these cases, the inspector is not specifically asked for an opinion. In the second, he is, though the task of reviewing his chief's decisions is a somewhat delicate one.

These repeated reviews of banking loans, overdrafts, etc., from varying standpoints and by different officials and directors, would, surely, give the greatest satisfaction to the shareholders, if they knew of their existence and operation.

If such reviews had been conducted, in all cases, in the past, with the same care and thoroughness with which they are carried out by all the great joint-stock banks to-day, it would have been a good thing for the shareholders of some of the institutions concerned.

Having dealt now with various classes of loan, and with some of the methods usually adopted to ensure, so far as it is possible to do so, that all advances shall

be of a satisfactory character, I propose to lay down a few general principles which should guide the banker in this matter of lending.

APPLICATIONS FOR FIXED CAPITAL

One of these I have already touched on in passing, namely, that it is not the function of a banker to provide his customers with "fixed" capital. This for the reason previously given, that a banker's resources must, in view of the nature of his liabilities, be kept liquid. The reply to a request for circulating capital, other things being in order, is "yes"; to a request for fixed capital it should be "no."

For example, a woollen manufacturer asks for an advance to enable him to build a factory, and offers, as security, the land and the building as it progresses. Such an advance, in the absence of very special circumstances, should not be granted. Another customer applies for accommodation for the purpose of purchasing wool at the wool sales in Coleman Street. This is a temporary, a "seasonal" requirement, and, the general features of the proposal being satisfactory, it should be met.

"SEASONAL" ADVANCES

"Seasonal" requirements may be financed, such as the requirements of cotton importers, during the cotton season, for the financing of cotton pending its sale to the spinners, or the requirements of the grazier, who wants money, in the spring, for the purpose of buying cattle which he fattens up during the summer and sells in the autumn.

The most curious instance of a "seasonal" advance which has come under my notice was that of an undertaker, who applied, in the autumn, for an uncovered

loan, assuring the branch manager, with the utmost confidence, that he would be able to repay the loan before the end of the year, as " his season commenced in November." It so happened, that year, that the month of November was singularly free from fogs, and matters looked doubtful, but ten days' fog just before Christmas restored the balance, and all was well.

Seasonal requirements are legitimate, and should be met as far as possible. The demand for loans to put into bricks and mortar and other forms of fixed capital are not legitimate, from a banking standpoint, and should not be satisfied.

" STICKY " ADVANCES

Firms and companies frequently do not understand the distinction I have just indicated. They consider that the banker should be satisfied with safety alone: " Your money will be perfectly safe. What more do you want ? " The banker knows otherwise. He knows, only too well, that safety is not enough ; that repayment within a reasonable time must also be kept well in view. Consequently, to the company whose loan or overdraft threatens to become permanent, he says : " It is permanent capital that you want, and it is your existing shareholders or the general public from whom you should take steps to obtain it." To a trader in similar circumstances he says—not quite so bluntly as this, of course : " You should get a partner with capital." To a private individual : " Get your solicitor to arrange a mortgage." To a corporation with a large and continuous overdraft he says, with the bated breath and in the honeyed tones which, for some reason, many bankers appear to consider necessary when they are dealing with corporations, " issue stock,"

or, rather, he sends what he considers a diplomatic letter, somewhat on these lines: "If, as is probably the case, you are contemplating an early issue of stock, we shall be happy to place our services at your disposal to that end, and to act as registrars of the stock when issued."

When suggestions of this kind are made—and the banker frequently has occasion to make them—much depends on the manner in which they are put forward. The successful banker must be an adept in the "art of putting things."

DISCOUNT BORROWERS' OPTIMISM

We have often been told in various banking treatises that the banker's first business is to know whom to trust. This is, of course, perfectly true, but inasmuch as rogues are in a very small minority in business, I suggest that one of the things which a banker has most carefully to guard against is not so much fraud, as undue optimism; optimism mainly on the part of borrowers or would-be borrowers, but also on his own part. The possible rascality of his customers is not what troubles the banker most, by any means, when he is dealing with an application for accommodation. His real *bête noire* is the optimism of the borrower, and one of his main duties is to detect that quality in his customer and to guard against sharing it himself.

It is really extraordinary how hopeful customers are apt to be with regard to their prospects and with regard to the punctual fulfilment of the promises of others to themselves, notwithstanding repeated instances of a contrary nature. You interview an inventor, for example. He applies to you for a loan the repayment of which depends upon his invention being adopted by some Government department to which he has

submitted it, and he assures you, in good faith, that this adoption cannot possibly be deferred more than a few weeks at the outside, though you happen to remember a similar application from the same source some two or three years before, when exactly the same belief was expressed.

May I say here, parenthetically, that the proper way for an inventor to finance his invention is to get a small syndicate to take it up, and to offer his banker the joint and several guarantee of the members of the syndicate, with or without collateral security as the case may be.

Another customer tells you that an advance, if made, will be repaid in a couple of months at latest from a source which he indicates, and there is no doubt that he fully believes that it will be, but you are acquainted with the financial position of the firm from which the money is due and you know quite well that it will be impossible for them to provide it within anything like the period suggested. Such instances could be multiplied indefinitely.

I was recently collecting, from various sources, and for quite another purpose than my present one, terse statements, from prominent bankers, of the chief elements which go to make a successful banker. Amongst those which I received was this: "A banker must be able to read character as well as a ledger, and to discount optimism as well as bills of exchange." This is so. Just as one of the most helpful attributes of a successful doctor is what is still, I believe, known as "a good bedside manner," so the ideal bank manager should, amongst other qualities, combine a pleasant manner with a pessimistic temperament, and if this temperament be lacking, he should cultivate it. It will be worth his while.

POPULAR ESTIMATES OF THE FINANCIAL POSITION OF BORROWERS

In George Rae's *The Country Banker* there is a chapter on "personal credit" which I venture to commend to your attention. From its contents I piece together the maxim: "Distrust popular estimates of the financial position of borrowers." As the writer truly observes, "the opinions afloat as to the means and position of people are mostly of a stereotyped character. The origin of these opinions is always more or less obscure, but when it once comes to be said—it does not seem to matter when or by whom—that so-and-so is good for so much, his worth will pass current for that amount for years without challenge, until some day he collapses, to the ruin of some, the injury of many, and the wonderment of all." This is true enough. Popular opinion does get stereotyped. When people once get the reputation of being well-to-do, it is really astonishing how they keep it. And yet it is less astonishing when one recalls that the same thing happens in other and very different spheres. You are a good golf or tennis player when you join a club and (fortunately) the reputation of being a good player will cling to you long after the foundation of it has gone. When you do badly, you are merely regarded as being "off your game." So with financial reputations. As George Rae puts it, "your customer may be losing money fast, to your knowledge. No matter. Popular rumour, until he actually gets the brokers in, credits him with being still in affluent circumstances."

Therefore, get your information at first hand, and up to date.

"SEASIDE" FINANCE

Another general principle is "Beware of 'seaside' finance."

Perhaps I can best explain what I mean by this by a reference to the way in which certain bank customers at seaside resorts are said to carry on the financial part of their occupations. One is disposed to imagine that if one had to get a living by letting lodgings, or by receiving visitors at a boarding house, one would live, in the winter, on the profit earned during the previous summer season. Thousands of people who earn their livelihood in this way appear to reverse the process. During the winter, when there is nothing doing, they borrow, and when the summer comes, they repay the advance if they have a good season, or fail to repay it if the season should be a bad one. Probably this is not their fault; they would most willingly do otherwise if they could; but the practice is obviously a reversal of the right method of financing. I have called this way of doing things "seaside" financing, but it is by no means confined to holiday resorts nor to those who gain a livelihood by entertaining visitors. It is the method which many bank customers in other occupations and trades endeavour to employ, and in warning the branch manager against "seaside" finance, I am warning him generally against a policy, on the part of borrowers, of anticipating problematical profits. Of course, a manager cannot prevent his customers from acting in the manner indicated, but he can at least guard against the bank being the means of aiding such action and rendering itself liable for the possible consequences.

LENDING TO LIFE-RENTERS

A further maxim also touched on incidentally in that storehouse of banking wisdom, *The Country Banker*, is "Be careful in lending to life-renters," to persons whose income is derived from life interests

only. Beware of annuitants in the capacity of borrowers without security. Such persons may be living in good style, but, often, their entire income is derived from trust or other funds in which they have only a life interest. Their income dies with them. Such people frequently anticipate their income, and are only too pleased if they are allowed to do so at their banker's expense. Either do not lend, or at least get security. At the very least, take a life policy. Even with a life policy, if you have lent beyond the surrender value and the borrower gets into financial difficulties, you can only get repayment if he dies, and this is generally the last thing he has any intention of doing. What if he elects, as I have been told he frequently does, to earn a precarious livelihood in some remote part of the Empire, whence your banking correspondent sends you, at your request, an annual report with regard to him, which it will be your unpleasant duty to embody in your statement of bad and doubtful debts: "We regret to have to inform you that when we last saw Mr. A he was not doing at all well in business, but was in the best of health." Or what if (without "electing") he stays at home and drags out a miserable existence while you continue to pay the premiums on the life policy—and hope for the best.

PERSONAL INTERVIEWS

Much trouble would be saved, and many misunderstandings would be avoided, if applications for banking accommodation and negotiations with regard to advances already made were more frequently dealt with in personal interviews, instead of by correspondence.

This applies, by the way, to other things than advances. It holds good with regard to any matters

as to which representations have to be made or explanations given by the manager to a customer.

A customer writes and states his requirements. There are several points in connexion with these, and with the security he offers, as to which the manager would like to make suggestions or ask explanations. In such cases it is very much more satisfactory for both parties if, the customer being within reach, he is simply asked to call. For the manager to have to enter into lengthy comments on the proposal by means of a letter is tedious, and he never knows the frame of mind in which the would-be borrower may happen to be when he receives the letter.

The same holds good in discussing with borrowers such matters as the rate of interest to be charged on an advance. With the customer in your room, such questions are easily settled. When he is at a distance, it often means a correspondence which may be unsatisfactory as well as lengthy. By all means let him have a line, if he wishes it, confirming the arrangement made, but make the arrangement orally if possible.

DIFFICULT POINTS FIRST

A point here, with regard to interviews generally. I have suggested elsewhere (*Present-Day Banking*, Butterworth & Co.) the desirability of asking your "awkward" questions at your first interview with a customer. I now go further, and suggest that such questions should be asked quite early in the course of the interview. In your private affairs, you have, from time to time, to see people and tell them something which you know will be distasteful to them, and you know quite well from your recollections of such incidents that if you start talking about other things first, it is often exceedingly difficult to "work up" to

the disagreeable part of what you have to say afterwards. Remember the proverb, *Ce n'est que le premier pas qui coûte*; get the distasteful part of your task finished without delay; you can then go on to other things which will leave a more pleasant impression. In many cases this holds good in correspondence also. You are offered, we will say, a participation in the underwriting of a public issue. The offer has been an oral one and you have promised to reply within an hour. If you decide not to accept the participation, don't begin your reply (if it has to be in the form of a letter) with the flowery expressions and end up with the refusal. Decline the offer, gracefully, in an early sentence, and end up with your thanks for the offer and an expression of the hope that you may be allowed similar opportunities in future. Incidentally, and quite apart from the point under consideration, you will be well aware that refusal to participate in the underwriting of a particular loan frequently means that you will have no further offers of underwriting from the house that makes you the offer. Underwriters do not care much for sub-underwriters who pick and choose. They prefer those who "take the rough with the smooth."

LENDING ON JOINT ACCOUNTS

I have been surprised to find a misconception in some cases with regard to joint account holders as borrowers. A new manager at a small branch of a bank allows an unsecured advance to, say, three customers who have a joint account at the branch. He knows that one of the three is undoubted for any accommodation, within reason, for which he may ask, and it is on the strength of the name of that one that he allows the advance. What he overlooks, or does

not know, in spite of the warnings of the textbooks, is that if any one of two or more joint borrowers should die, it is to the others, and to them only, that the bank can look for repayment, since the death of the other releases his estate from all liability for the debt, and if the one who dies should happen to be the one on whose financial position the manager has relied, the resulting position may be very awkward.

For some inscrutable reason, this is, at times, overlooked by an inexperienced manager. The way out of the difficulty, or rather the way to prevent it from arising, is to get all three of the account holders to sign a letter establishing "several" liability. Most banks, I believe, have a printed form for this purpose, and this fact alone should put managers on their guard.

One of the first questions which would be raised by the controller at the head office on receiving an application for such an advance would be, "Has Form number so-and-so (establishing several liability) been signed by the borrowers?" But such a question should not be necessary. It should be foreseen, and the advance put on a proper basis in the first instance.

TRUSTEES' ACCOUNTS

Everyone in a bank knows that when an account is opened in the names of trustees, all the trustees must sign the cheques, unless, of course, the deed creating the trust expressly provides otherwise, which it very rarely does. It often happens, however, that one or more of the trustees is in some remote place and that it is impossible for his co-trustees to obtain his signature to the cheques within anything like a reasonable time. In such instances the trustees frequently ask the bank to allow some of them, only, to sign.

If, in such exceptional cases, the head office officials,

satisfied as to the circumstances, should agree to the request, it will only be on condition that the trustees indemnify the bank against any loss which such an arrangement may entail, and that they will all, periodically, sign a statement to the effect that they have examined the passbook and that the entries in it are correct.

One has known trustees very difficult in this matter, but the precautions suggested are obviously necessary, and their reasonableness should be easy to justify.

CORRESPONDENCE WITH AND ABOUT BORROWERS

It is quite impossible, within the limits imposed upon me, to deal with more than a fraction of the points which may arise between the banker as a lender and his borrowing customers. About one important section of such borrowers—local authorities—I should very much have liked to say something, but there is so much to be said that it is not advisable to start on the subject ; it would require a course of lectures to itself. The points already mentioned in this lecture must be regarded as typical of the many other points which might be raised. I propose therefore to conclude by touching on a few points in connexion with correspondence with borrowers and correspondence with head office with regard to them, and in doing this it is the branch manager, or the aspirant to branch management, whom I shall address.

I have already suggested that communications with customers with regard to advances, as well as with regard to other matters, should, as far as possible, be oral, but it is clear that in very many instances this cannot be arranged, and that it will be necessary to communicate with them by letter.

Borrowers of one class seem particularly touchy. I refer to those who take an advance, without any arrangement, in the form of a casual overdraft. The cheque creating the overdraft is referred to the manager by the cashier before it is paid, and the manager, having sanctioned the payment, gives instructions for the bank's usual printed letter to be sent calling the customer's attention to the overdraft. This printed letter is, generally, very tactfully worded, but there seems to be always a risk, notwithstanding this, of its giving offence to the recipient. Assuming that the manager knows that the overdraft is safe—presumably he would not have allowed it otherwise—it is sometimes better to write a special letter, or at least for the manager personally to add a phrase at the foot of the printed letter, indicating clearly to the customer that the *raison d'être* of the communication is the possibility of some mistake having been made in the bank's books and the desire that such mistake should be pointed out to the bank and rectified. If the customer resides or has his place of business in the neighbourhood of the bank, a note from the manager, not referring to the overdraft but merely asking him to call when he happens to be near or passing, is better still.

This last-mentioned course is also much preferable to a written remonstrance when a substantial borrower who has an overdraft limit has drawn considerably in excess of the limit. Ask him to call, and he will not mind. Tell him in a letter that his account is considerably in excess, and he frequently expresses annoyance.

I have, it is true, heard of cases in which the receipt of a most politely-worded note asking a customer to favour a manager with a call has had the effect of

keeping the recipient awake all night wondering why the manager wanted to see him. I am afraid I can offer no suggestion as to how to deal with customers so "thin skinned" as this.

The wise branch manager will never communicate to a customer the requirements of his head office with regard to an advance in the exact terms in which those requirements reach him. If he cannot actually see the customer, he will suitably paraphrase his instructions. Just as, when an enclosure is sent by head office to a branch or by a branch to head office, the letter will say "We enclose," etc., whereas if the enclosure is sent by either of these parties to a customer or other correspondent, the letter will say "We have pleasure in enclosing," so neither head office nor a branch, when writing to each other, will waste words over the subject matter of the letter. Each will go straight to the point, without verbiage. In communicating with customers, the verbiage is generally necessary, and should be included.

The manner in which a branch manager conducts his correspondence with his head office with regard to lending transactions is a matter of considerable importance to himself. It is one of the many tests which his general managers apply when they form an estimate of his efficiency. Of course they have other tests; their knowledge of his record in the service, their personal impressions of him, the reports of their inspectors, the casual and incidental testimony of such of his customers as they may meet, and last, but not least, the profits shown by the profit and loss return of his branch. But the manner in which he deals with borrowers, both as regards the borrowers themselves and as to the representation of their case to headquarters, is a test of his ability which is applied almost daily.

Some managers always have difficulty with borrowers; others, so far as head office sees, have little or none; and there is no doubt that, in banking matters, some managers really contrive to educate their customers in sound banking principles, getting them into the way of seeing a transaction from their banker's standpoint as well as from their own.

I suppose the most fatal mistake which a branch manager can make in the class of transaction which has formed our theme while we have been considering the lending function of a banker is to side, openly, with the borrower against his head office; to take the line "This is what these unreasonable people say. I don't agree with them. I think their requirements absurd, but if I were you I should fall in with them." When a manager disagrees with the views of head-quarters, it does not necessarily follow that the head-quarters' view is the correct one. In the majority of cases, though, it probably is, since the men who form and express that view are, for the most part, highly qualified officials, who, in addition to their other qualifications, have had considerable personal experience of the difficulties which beset a branch manager. What a branch manager should do, and what those of them who know their business actually do when they differ from head office with regard to a particular transaction, is to re-state their case to headquarters before communicating with the borrower or would-be borrower. Such a re-statement will always command attention, but if it should not have the effect of altering the view previously taken, then that view should be put to the customer as the view of the bank, and not as an arbitrary decision. In Dr. Henderson's textbook on the Art of Writing, *The English Way* (Macdonald & Evans), Mr. F. W. Gray, B.A., Assistant Secretary of

the Institute of Bankers, in his excellent chapter on Banking Correspondence, puts this point very neatly: "If you are called upon to communicate to the customer an unfavourable decision received from your head office, do not imagine that you will earn your customer's respect by siding with him against the bank whose representative you are." Exactly After all, it is the head office which pays the piper and which is therefore entitled to call the tune.

This, however, is in a sense a digression. The point before us is the manner in which a case should be presented by the manager to his head office.

One thing he should never do, and that is submit a proposal which he himself cannot recommend. I will say nothing here of the annoyance caused at headquarters when three solid pages of a proposal have been carefully perused, and page four is found to contain the statement "I cannot recommend this transaction." In my younger days, when one of my duties was to "devil" for a general manager of a comparatively small bank who himself dealt with proposals for accommodation above a certain figure, I used, when such a proposal came in, as it did very occasionally, to attach a slip to it to the effect that the manager did not recommend it, and thus save my chief the waste of time involved in its perusal, for when a branch manager, who knows his customer and his circumstances, does not approve a transaction, it is most unlikely that his head office will pass it.

But, further, the experienced branch manager will know, almost as well as the officials at head office, what kind of transaction will be acceptable to them and what kind will not, and in his own interests, he will not put forward and recommend a proposal which he knows

they will not approve. In reading one of Mr. F. R. Stead's books recently, I came across the statement that in the case of his bank, there was one manager whose proposals relating to advances, received over a period of years, had been approved in every case except one. There is no doubt that, when one sees the signature of certain managers to proposals, one knows they will be sound, while the signature of others—of course a very small minority, in the case of every bank—constitute in themselves a note of warning.

By degrees, the soundness of the judgment of a manager becomes impressed on his chiefs at headquarters, and forms an important element in the decision when the question of promotion arises.

There is another suggestion in connexion with correspondence which may be of service to those of you who are branch managers or who have at times to take charge of a branch. It is, never hesitate to seek guidance from your head office on a point of any importance which comes under your notice for the first time and as to which you are at a loss to know how to act. There are very many difficulties which only very rarely occur at a particular branch, but which occur fairly frequently at one or more of the hundreds of branches of your bank and which, for that reason, come before the head office fairly frequently. May I give an illustration which occurs to me, although this particular case is quite an unimportant one. I remember calling at a branch and finding the manager considerably puzzled over a letter he had received from the treasurer of a local authority requesting him to pay, out of a small balance to the credit of a customer who was a pauper lunatic, certain small amounts due to the authority for the customer's maintenance and

other incidental expenses. Perhaps, for the credit of the bank, I ought to add that it was a deposit account only.

It so happened that, the previous week, the head office had had precisely similar cases, also of small deposit accounts only, referred to it from two other branches, and had referred the manager to an Act of Parliament meeting the case and directing the bank how to act. This is one of the advantages of a head office. It has sources of information on all sorts of matters which rarely crop up at a particular branch, but which fairly often arise amongst the branches as a whole, and that information is always at the disposal of its managers if they find themselves unable to obtain it from the usual sources.

On another point in connexion with correspondence with headquarters with regard to the accounts of borrowers I venture to make a suggestion which I feel sure will be received in the spirit in which it is offered. The suggestion is that such correspondence should be as brief and "pithy" as possible; that all extraneous and immaterial details should be omitted. I once wrote, for a banking paper, some suggestions to branch managers under the title "Banking Don'ts," in which I included a reference, partly *bona fide* but largely of a chaffing nature, and I am afraid somewhat satirical, to this matter, and the editor of the paper received a letter from a branch manager somewhere in the country indignantly remonstrating with him for publishing the suggestions, and sending a savage list of "Don'ts for Head Office," which was duly published. I was much younger then, and I am afraid that some of my "Don'ts" were a little severe. One of them was "Don't enclose, to be read and returned, rambling and irrelevant letters from customers, even when they end

on a note of warmest thanks for your unremitting attention to the interests of the writers. If a brief summary of the essential features of the correspondence will not quite meet the case, set a youngster in your office to work to copy out certain passages, including the flowery ones at the end, and run your pen (lightly) through the latter before forwarding the budget."

This was too bad of me, and the only excuse I can offer is that it was written more than 20 years ago and republished (in *Present-Day Banking*) so long as 16 years ago. The chaffing implication it contains I unreservedly withdraw, but I adhere to the main idea, which is that all communications between branch and head office and between head office and branch should keep as much to the point as possible. I well remember, though it is more than 20 years ago, being in a northern city with my general manager and a committee of directors for the purpose of going through the more important accounts at a large office. Just as the committee commenced its session, an important proposal was received from another branch, accompanied by a letter which took up 16 pages of letter paper—not note paper. As secretary to the committee I was asked to " boil it down," and succeeded without difficulty in compressing the contents of the 16-page letter into a page and a half, which was all that it was necessary to read to the directors and all that was read to them. This is, of course, a very extreme case. My own opinion is that any proposal which needs a very long epistle to commend it is likely to be badly in need of support, but this by the way. On the main point under consideration I will vary, by one word, the dictum of the chairman of one of the banks with which I have been connected, and say " lengthy communications corrupt good management."

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